January 20, 2021

The Honorable Anne Kaiser
Chair, Ways and Means Committee
Maryland General Assembly
House Office Building, Room 131
6 Bladen St., Annapolis, MD 21401

Re. House Bill 215 – Income Tax – Carried Interest – Additional Tax

Dear Chair Kaiser:

On behalf of Maryland's startup ecosystem, including its entrepreneurs, employees, and investors, I write to respectfully oppose HB215. While we appreciate the State government's work to fund important policy initiatives, we are concerned that this bill would ultimately work against that purpose by slowing the growth trajectory of Maryland's thriving startup economy, costing the state jobs and economic competitiveness. In terms of impact on the state budget, HB215 will end up creating a significant net loss in tax revenues.

The state of Maryland is currently a story of success for growth in startup activity. In the past decade, the number of startups who raised venture capital (VC) funding in the state nearly doubled and the amount of VC funding invested into the state nearly *tripled*. In 2020, 131 Maryland startups secured $1.2 billion dollars in VC investment, setting a record for venture capital invested into the state. These entrepreneurs are seeking to build the next generation of Maryland companies, specializing in fields such as biotechnology, climate technology, cybersecurity, computer software, and hardware. This impressive growth has made Maryland a top twenty destination in the nation for VC activity.

Examples of companies in Maryland that have been built with venture capital include Columbia-based Tenable, a cybersecurity firm with 1,400 employees working in the area of cyber exposure; and 2U, a company based in Lanham with roughly 2,700 employees working on democratizing access to college educations by bringing more degree programs online. Companies currently backed by venture capital include Delfi Diagnostics, a Baltimore-based firm that is developing a blood test for early detection of cancer; Xometry, a Gaithersburg-based firm developing a platform to facilitate relationships between product designers and manufacturing facilities; Catalyte, a Baltimore-based firm with 800 employees focused on workforce development for technology jobs; and Cybrary, a company in College Park developing a cybsecurity and IT training platform.

Simply put, when VC succeeds in Maryland, workers, cities, and the state all gain. The legislation before you would severely jeopardize the continuation of that success.

As background, VCs create partnerships to combine the capital held by pension funds and other institutional investors with their talent and expertise to make high risk, long-term equity investments into innovative startups. These are generally partnerships that last ten to fifteen years, building investments far longer than any other asset class. Most VC investment dollars are used to fund research and development and employment activity in their portfolio companies. A recent research paper produced by Stanford University found that of the 1,339 companies that have gone public between 1974 and 2015, a full 42 percent can trace their roots to venture capital. Companies built with venture capital also tend to be at the cutting edge of economic competitiveness, accounting for an astounding 85 percent of all research and development spending by companies that have gone public since 1974.

Startups tend to cluster close to their investors as venture capital is a very hands-on activity. The skill set of VC is far beyond simply providing investment. VCs often take board seats, work closely with entrepreneurs and their teams, provide strategic advice, and generally do whatever they can to help their portfolio companies succeed. Some startups are actually incubated by VCs before being spun out into their own entity.

HB215 would impose a 17 percent surtax on any profits that Maryland-based VCs may realize on startup investment, if their fund is successful. This would be in addition to all other state and local taxes due. It's important to note that Maryland already taxes any capital gains (including carried interest) at similar levels to wage income, so there is no differential. If passed, venture capital activity would be taxed at a rate 400 percent higher than other income in the state. To provide a regional context, HB215 would impose a state tax burden on VC investment more than seven times that of a startup investment in neighboring Pennsylvania. In addition, this legislation would impose the same surtax on many investments into Maryland startups coming from out of state as well. The bill appears to acknowledge the negative impact of this unprecedented tax increase by attempting to exempt real estate investment from the surtax.

We are concerned that HB215 would disadvantage Maryland start-ups across a host of important sectors by making investment in their success regionally and nationally uncompetitive. Like you, we have seen instances in the past where a bill unintentionally provides economic development officials representing neighboring states an opportunity to attract Maryland businesses and investment. As you contemplate your need for revenue, we urge you balance those considerations with the fact that this surtax would facilitate a poaching of high-growth companies by other jurisdictions on an unprecedented scale.

Maryland has built many successful companies across the state and created thousands of 21st century jobs for its residents. We believe that HB215 would jeopardize the future of Maryland's robust startup economy, costing jobs and reducing state tax revenues. For these reasons, we respectfully ask you to reject this legislation.

Sincerely,

Bobby Franklin

Bobby Franklin
President and CEO

CC: Members of the Ways and Means Committee