

## Portland's income tax scares VCs

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Gordon Hoffman and Bill Newman are getting ready to move their seed capital firm, [Northwest Technology Ventures LLC](#), out of downtown Portland to suburban Beaverton.

It's not that the partners don't like being downtown. They've shared office space with venture capital firm SmartForest Ventures LLC and another early-stage capital investment firm, [Capybara Ventures LLC](#), for several years -- an arrangement that has made it easy for the three firms to share deals and incubate new companies.

Hoffman and Newman are doing what other Portland-area venture capitalists have done before them: taking their investors' money out of Multnomah County and the city of Portland to avoid a combined tax of 3.65 percent on net income.

The effect of the tax on limited partnerships isn't just driving local VCs to offices in Lake Oswego, Beaverton or other cities outside Multnomah County.

"We've heard that no new fund will set up in Portland," said Newman. That could keep the level of investment capital available for new companies lower than Portland would like it to be.

That's not an effect anyone should be looking for from the business income tax, commonly known as BIT, said incoming Multnomah County councilor Jeff Cogen, who will represent North and Northeast Portland starting Jan. 1.

"As a region, we need to be attracting venture capital," said Cogen. "Our economy depends on growing new jobs, and venture capitalists are supporting and nurturing the companies that will provide new jobs to our people. "If there's something in our tax policy that prevents venture capital from being in Multnomah County, that's something I'd like to improve."

What particularly galls Newman, Hoffman and other VCs is that mutual funds do not have to pay tax on their investors' gains.

That's because these firms have an exemption as regulated investment companies, said Scott Karter, audit supervisor for Portland's Revenue Bureau.

They also don't show any income for their investments on their Oregon tax returns, as they distribute all gains to their investors. And Oregon tax returns are the basis for levying the city's business income tax.

Instead of paying a 2.2 percent tax to Portland, and a 1.45 percent tax to Multnomah, mutual funds pay a \$100 license fee.

The fact that mutual funds are exempt when venture funds are not is a distinction without a difference, say Portland-area VCs.

"The [venture firm's] partnership is a pass-through," said Hoffman.

Just as people who own shares of mutual funds eventually pay capital gains tax on these investments, so do the limited partners with money in venture funds pay tax on their capital gains, once they receive them.

Northwest Technology Ventures has not yet had to pay any taxes on its fund; Hoffman and Newman are still investing money, and none of their portfolio companies have gone public or been purchased yet.

But the partners don't feel that they, as investors in their own fund, should have to pay the BIT when there is a liquidity event.

SmartForest, a much larger firm than Northwest Technology Ventures, has solved the problem by splitting off its limited partnership -- the actual money that is invested on behalf of the limited partners -- from the management firm that invests the money.

SmartForest is seeking a new downtown Portland location, as its lease is about to expire.

But the firm had already moved its limited partnership to Lake Oswego, so the fund would not have to pay city and county BIT taxes.

Mackworth and Coleman are happy to pay the BIT for their management firm, he said; after all, they employ people and use Portland and Multnomah services.

But, "we have a fiduciary responsibility to maximize our limited partners' investment, and there's no need or benefit for them in paying the business tax. So we structured things in a way they don't have to."

Mackworth and partner Debi Coleman "like having offices downtown," he said. "There's a certain efficiency to be gained with the density of businesses there." Some of SmartForest portfolio companies are located downtown, as well as advisers, lawyers and accountants.

Like the SmartForest partners, Hoffman and Newman have other reasons, besides the BIT, for choosing to locate their new office on the campus of [Oregon Health & Science University's OGI School of Science & Engineering](#) in Beaverton. "All of our invested companies, save one, are now or soon will be outside the city and county," said Hoffman. Being near their companies will be more efficient for Hoffman and Newman, and parking at OGI is easier and cheaper than downtown, both for the partners and for any entrepreneurs who present to them.

Capybara partners Eric Rosenfeld and Bob Ward are still on the fence about where to go next.

They'd like to stay downtown, "but is the benefit worth 3 percent of our money, both ours and our investors?" said Rosenfeld.

He and Ward are considering working with other venture capitalists to lobby the city for an exemption to the BIT.

That would probably work, said Rick Hawkins, director of the tax department at downtown Portland accounting firm Geffen Mesher & Co.

Hawkins took up Hoffman's and Newman's request for exemption with the city's Revenue Bureau, but said to get it approved might mean going all the way to the City Council.

That would be too expensive and take too much time, said Hoffman. "We have a business to run."

Hawkins thinks that venture funds are similar enough not just to mutual funds, but also to untaxed trust accounts that banks hold for clients, that the venture capitalists could make a case.

It would also make sense for a group of them to share the \$10,000 to \$15,000 it's likely to cost to win the exemption.

"My sense is that the city would listen to you, if you made the carve-out [exemption] narrow enough so that it doesn't include other partnerships," Hawkins said.

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