House Committee on Ways and Means

Senate Committee on Finance

Joint Hearing on Tax Reform and the Tax Treatment of Capital Gains

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Testimony of:

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Chairman Camp, Chairman Baucus, Ranking Member Levin, Ranking Member Hatch, and Members of the Committee, my name is William Deming Stanfill. I am general partner of Montegra Capital Income Fund. I was a founding partner and head of the Denver office of TrailHead Ventures, a private venture capital partnership whose investment focus is information technology.

I've been involved in the securities business since the late 1960s, first as a stockbroker with Dean Witter and Co., then as a money manager, venture capitalist, angel investor and asset-based lender. I've done well: provided for my family, educated our children and invested considerable resources in charitable and civic initiatives.

I joined the Centennial Funds of Denver in 1982 and was responsible for the firm's fund of funds activity. We invested in 30 venture partnerships around the United States. Those partnerships collectively invested in 600-700 portfolio companies including telecommunications, medical, and information technology, throughout the country: Massachusetts to California, Florida to Oregon, Colorado and Utah, Arizona, Texas, and New Mexico, Alabama and Georgia.

In 1995, I left the Centennial Funds, purchased the fund-of-fund activity and formed Trailhead Ventures to invest directly in early stage information technology enterprises. By industry standards we are a small fund. Our advantage is our ability to provide seed and early-stage capital of $2-4 million to start-up companies.

In 2009 I jointed Montegra Capital Resources, Colorado's leading asset-based lender for more than 40 years. Montegra principal, Bob Amter, and I formed the Montegra Capital Income Fund, which provides short term financing for first mortgage-secured loans. The Fund offers capital preservation and income generated by a diversified loan portfolio.

For 45 years I've competed for investors with investment funds of all kinds: oil and gas exploration funds, real estate development funds, timber funds, private equity funds – you name it. They all had souped-up tax treatment: accelerated depreciation, up-front deductions for exploration and development, special rates for timber sales, big interest deductions for leveraged buyouts. Invariably, they spent more time and energy on the tax structure of the deal than the underlying economic merits of the investment. Frequently, investors I lost to these 'sophisticated' product offerings would boast about the money they saved on taxes. Seldom did they crow about the rate of return earned from the deal. Occasionally they screamed when they had to repay recapture taxes.

My goals and the goals of the firms and individuals I work with are simple: make money by leveraging the creativity, talent and passion of entrepreneurs. Whether venture, equity or angel investing, the vagaries of the tax code haven't driven our investment strategy or decisions. In the 45 years I have been in this business, I can't remember one client whose investment decision was made based on the tax rate – and I certainly never made such a decision myself.

Rather we look for entrepreneurs who have good ideas and an obsession to bring them to market – a fire in the belly. We make investments because we believe in the goals of the entrepreneur and think there's a potential profit for us and our investors. Those decisions don't change based on whether we pay a 15 or 20 or 28 percent tax rate on our gains. We're looking to leverage talent, not tax breaks.

What limited partners should expect from a venture capital investment is a 500 basis point (5%) premium over a portfolio of publicly-traded securities. And that premium is not a risk premium, but a premium for illiquidity. Why? Because our investment partnerships usually have a ten-year lifespan. In addition to that premium, the investor gets a lottery ticket and the results can be substantial. In the first Trailhead Fund, we have produced a 54% internal rate of return net to the investor and if we liquidated the remaining public securities today, we would return 10 to 11 times our partners' capital.

The preferential tax rates for capital gains and dividends are simply a windfall for wealthy investors. In my view this special tax treatment is neither fair nor equitable or available to any other professional endeavor. After all, a gifted teacher who is inspiring and challenging our children and enriching *human* capital gets no such special treatment.

Some predict that firms will locate overseas, taking jobs and tax revenue out of the country. My firm is too small to play in the international field—the learning curve is too steep and the costs are too high. And because we believe in seed investing, we've always found sufficient deals in our own backyard. Further, my accountant advises me that if we did move our fund offshore, as a U.S. citizen, I am still subject to U.S. tax on my income.

I have loved my work over the past decades and I would not stop doing it because my tax rate was adjusted. I do not believe that higher capital gains tax rates will drive venture capitalists and other investment managers to look for other lines of work. We like the excitement and satisfaction of assisting management in transforming good ideas into successful businesses. We get ample compensation, financial and psychic, for the work we do and the risks we take. We share handsomely in the profits and earn fees along the way.

For more than 45 years I've contended with capital gains rates as high as 28 percent and as low as the current 15 percent. Never has a client, investor, partner or entrepreneur hesitated to invest because of the tax rate on capital gains. Tax rates were merely part of the landscape. We kept our heads in the game, making long term investments that had merit. We managed risk, not the tax code. We played by the rules and we prospered.

The sky will not fall if the rates go up.

We've seen this movie – Chicken Little – before. Our industry won't end or be significantly disrupted if tax reform raises the rates on capital gains, any more than the auto industry ground to a halt when mileage standards, seatbelts, and air bags were mandated – although the auto industry's executives certainly predicted such doom at the time.

It's disturbing that the richest country in the world doesn't assure quality healthcare for low-income children, quality life-long education for all or first-rate medical care for our injured soldiers. I am dismayed that these and other human priorities remain ignored while we pretend we can afford to continue these tax breaks.

Frankly, I was reluctant to testify on this occasion for, like the vast majority of my fellow citizens, my faith in the U.S. Congress, to set aside party and ideology and do the people's business has been dashed. But I'm nothing if not resilient and hope springs eternal. So here I am, urging you to lead and find a win-win solution and forge comprehensive tax reform.

What better way to begin than to tax all income – wages, dividends, capital gains, royalties – alike. End preferences, close loopholes, eliminate most, if not all, deductions and add a dash of progressivity. Let the market, instead of the tax code, determine the allocation of investment capital. Let the various legal, accounting and lobbying industries re-invent themselves and do productive work for a change.

We have a choice. We can change the tax code in favor of equity and fairness. Or we can continue to cut back vital services and pile up debt while we give tax breaks to the wealthy. Let's not come to the same conclusion reached by Walt Kelly and his mouthpiece, Pogo, "we have met the enemy and he is us."

Thank you and I would be pleased to answer your questions.