

Minnesota Angel Investment Credit

What is the angel investment credit?

The Minnesota Small Business Investment Credit (commonly referred to as the angel investment credit) provides qualified investors in certified small businesses with a refundable income tax credit equal to 25 percent of their investments up to a maximum of \$125,000 (\$250,000 for married joint filers). The angel investment credit was enacted by the 2010 Legislature to encourage investment in emerging Minnesota small businesses. It took effect for tax year 2010 and is scheduled to expire for investments made after tax year 2014.

Three key sets of requirements apply under the credit:

- Rules that govern which investors qualify to make investments
- Rules specifying the types of businesses that qualify to receive investments
- Limits on which investments qualify

What investors qualify for the credit?

The angel credit allows two different types of investors to qualify for the credit:

- **Individual investors** qualify either by being accredited investors under Securities and Exchange Commission (SEC) Regulation D or by certifying that they will only invest in an offering that is exempt from registration under state law. Accredited investors generally must have net worths of at least \$1 million (excluding the value of their homes) or annual income of at least \$200,000 (\$300,000 for married couples).
- **Qualified funds** are pass-through tax entities, such as LLCs or S corporations that invest in qualifying small businesses and have three or more investors who each meet the requirements for individual investors. These funds pass through the credit to their individual owners, who claim it on their own tax returns.

Investors must apply to and be certified by the Department of Employment and Economic Development (DEED) before making the investment for which they are claiming the credit. However, individuals who are not accredited investors but who qualify because the offering is a small corporation exempt from registration may apply up to 30 days after making the investment. Investors (either individuals or funds) or members of their immediate families may not derive more than 50 percent of their gross annual incomes from the small business.

What small businesses qualify under the credit?

A qualifying small business (i.e., one in which an investment qualifies for the credit) must:

- Have its headquarters and 51 percent of its employees and payroll in Minnesota;
- Be engaged in a specified field of business that involves some type of proprietary technology or product;
- Have fewer than 25 employees;
- Pay its employees wages equal to at least 175 percent of the federal poverty

guideline for a family of four on a full-time equivalent basis (executives, officers, and owners are excluded from this requirement);

- Have not been in operation for more than ten years;
- Have not received more than \$2 million in private equity investment; and
- Be certified by DEED as meeting these requirements.

What types of investments qualify for the credit?

To qualify for the credit, an investment must:

- Receive DEED credit certification from the annual credit cap;
- Be made in cash (other types of property or providing services to the business do not qualify);
- Satisfy minimums of either \$10,000 (individual investor) or \$30,000 (fund); and
- Receive in return an equity-type interest (e.g., common stock, partnership interest, preferred stock, or debt with a mandatory conversion to equity).

What is the maximum credit for a business?

The law prohibits DEED for certifying more than \$1 million in credit allocations to any one business. Thus, a business that attracts \$4 million of qualifying investments could receive the maximum credit. No lifetime maximum credit applies to investors beyond the annual limits of \$125,000 (\$250,000 for married joint filers).

How much will the credit reduce state tax revenues?

The law imposes an annual dollar limit or cap on the total amount of credits. The Department of Revenue has estimated that credits will be claimed up to the full amount of the limits. Some of these credits may be paid as refunds (rather than reducing tax liability), since the credit is refundable. The total limit over the life of the credit is \$58.9 million:

- \$11 million for tax year 2010
- \$12 million per year for tax years 2011 through 2014, except the 2013 amount is reduced by \$100,000 to fund a program evaluation

DEED administers the limits by certifying dollar amounts of credits to applicant investors on a first-come, first-served basis.

Has the demand for credits exceeded the limits?

Credit applications for tax year 2010 were about \$4 million less than the limit. Under the law, the \$4 million in unused credits carried over to tax year 2011, increasing the limit to \$16 million. Applications for tax year 2011 used up the full \$16 million by November, requiring DEED to reject some applicants. If this pattern persists in tax year 2012, applications will far exceed the \$12 million limit.

Do clawback provisions apply?

The law provides for revocation and repayment of the credit if the small business does not maintain at least 51 percent of its employees and payroll in Minnesota for five years starting the year after the investment was made. The required repayment declines by 20 percentage points per year (100 percent in year one, 80 percent in year two, etc.). The business, not the investors, must make the repayment.

What reporting requirements apply?

Investors, funds, and small businesses must annually report to DEED on their compliance with the law. DEED must annually report to the legislature. In addition, the law provides for an independent program evaluation to be completed by January 2014.

For more information: See the DEED website: http://www.positivelyminnesota.com/Business/Financing_a_Business/DEED_Business_Finance_Programs/Angel_Tax_Credit.aspx.

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