

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 maximum credits for investments in a business cannot exceed \$1 million. The credit took effect for tax year 2010 and expires for investments made after tax year 2017.

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 Regulation D or by certifying that they will only invest in an offering that is exempt from registration under state law. Accredited investors must have net worth of at least \$1 million (excluding the value of their homes) or annual income of at least \$200,000 (\$300,000 for married couples). Beginning in tax year 2015, individuals who are officers of or who in combination with their family members own or control 20 percent or more of the business cannot claim the credit.
- **Qualified funds** are pass-through tax entities 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 owners, who claim it on their 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 that is exempt from registration may apply up to 30 days after making the investment.

What small businesses qualify under the credit?

The credit only applies to investments in a small business that DEED certifies:

- Has its headquarters and 51 percent of its employees and payroll in Minnesota;
- Is engaged in a specified field of business involving proprietary technology or product;
- Has fewer than 25 employees;
- Pays most of its employees wages equal to at least 175 percent of the federal poverty guideline for a family of four;
- Has not been in operation for more than ten years (20 years for businesses developing drugs or medical devices that require FDA approval); and
- Has not received more than \$2 million in private equity investment.

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;
- Satisfy minimums of either \$10,000 (individuals) 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).

How much will the credit reduce state tax revenues?

The law imposes an annual dollar limit or cap on the total amount of credits. 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 \$91.9 million:

- \$11 million for tax year 2010
- \$12 million per year for tax years 2011 through 2013, except the 2013 amount is reduced by \$100,000 to fund a program evaluation
- \$15 million per year for tax years 2014 through 2016
- \$10 million for tax year 2017

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?

Applications for tax years 2011 through 2016 used up the full allocations and the amount carried over before the end of the year, requiring DEED to reject applicants in all three years.

How many businesses and individuals benefited from the credits?

The table shows the number of investors (including those investing in funds) and businesses for 2010 through 2015.

Calendar year:	2010	2011	2012	2013	2014	2015
Number of businesses	67	113	117	128	110	114
Number in metro area	62	102	109	122	102	101
Percentage of \$ in metro area	94%	80%	95%	95%	86%	92%
Number of investors	290	758	656	651	812	817

Beginning in tax year 2015 half the allocation is reserved for investments in Greater Minnesota and in women- and minority-owned businesses; any reserved amounts not allocated by September 30 become available for other qualifying investments. Of the reserved amount, \$4.35 million in tax year 2015 and \$2.4 million in tax year 2016 was used for the specified investments by September 30, and the balance was allocated to other investments.

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.

In addition, investors or funds that do not maintain their investment in the small business for at least three years must repay the credit.

What reporting requirements apply?

Investors, funds, and small businesses must annually report to DEED on their compliance with the law. DEED annually reports to the legislature.

For more information: See “Angel Tax Credit” under the “Financing a Business” area on the DEED website: <http://www.positivelyminnesota.com>.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.