HOUSE RESEARCH
Bill Summary

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Overview

This bill provides a 25-percent nonrefundable income and corporate franchise tax credit for angel investors. To qualify, minimum investments of $10,000 (for individuals) or $50,000 (for funds) must be made in qualifying small businesses or QSBs. QSBs are defined as businesses with 51 percent of their operations in Minnesota and fewer than 25 employees. They must be engaged in "innovation" in a qualified high technology field, or in developing technology for use in tourism, forestry, mining, or transportation, or in green manufacturing.
Taxpayers must be accredited investors under Securities and Exchange Commission (SEC) Regulation D to qualify. For individual investors, Regulation D requires either $1 million in net worth or $300,000 in annual income for the past two years for a married couple ($200,000 for a single individual). Investors must apply to and be certified by the Department of Employment and Economic Development (DEED) to receive the credit.
The bill limits the annual amount of credits to $10 million per year for tax years 2010 and 2011 and to $12 million for later tax years. The credits may be transferred or sold once under limited circumstances.

Section

1 **Small business investment credit.**

Subd. 1. Definitions. Defines the following terms for purposes of the section:

Qualified small business (QSB) must meet several requirements to be a qualified business:

- **Minnesota location** – The business must have the following in Minnesota: (1) its headquarters, (2) 51 percent of its employees, and (3) 51 percent of its payroll.

- **Line of business** – The business must be engaged in (or committed to engage in) "innovation" in (1) a qualified high technology field (either by research or developing a proprietary product or service or using proprietary technology), a term that is defined below; (2) researching, developing, or producing proprietary technology for tourism, forestry, mining or transportation businesses; or (3) green manufacturing, also a term defined below.

- **Prohibited activities** – The business must not be engaged in any of the following (unless it is an ancillary part of the functions described under line of business): (1) real estate development, (2) insurance, (3) banking, (4) lending, (5) lobbying, (6) political consulting, (7) wholesale or retail trade, (8) leisure, (9) hospitality, (10) transportation, (11) construction, (12) ethanol production from corn, (13) professional services (attorneys, accountants, business consultants, physicians, and health care consultants).

- **Size restrictions** – The business must employ no more than 25 employees nor can it be a member of a unitary group that employs more than 100 employees. The business cannot receive more than $2 million in private equity investments. (This apparently does not count the investment that qualifies for the credit, since a separate higher limit of $4 million applies to the amount of investment in a business that can qualify for the credit.)

- **Age restriction** – The business cannot have been in operation for more than ten consecutive years.

- **Minimum pay requirement** – The business must pay its employees (other than the first five employees) wages equal to 175 percent of the federal poverty level for a family of four. This would require pay of about $10.60 per hour, based on the 2009 poverty thresholds, which remain in effect through March 1, 2010. Payment of benefits do not count under this requirement.

Qualified high-technology field is not explicitly defined, but a list of specific lines of businesses that do qualify is provided. These are aerospace, agricultural processing, alternative energy, environmental engineering, food technology, cellulosic ethanol, information technology, materials science technology, nanotechnology, telecommunications, biotechnology, medical device products, pharmaceuticals, diagnostics, biologicals, and veterinary science. Similar businesses or other businesses that can make a reasonable case that they are "high-technology" may also qualify.

Proprietary technology means unique and legally owned or licensed technical innovations, such as patents, copyrights, trademarks, and trade secrets.

Qualified green manufacturing is a business whose primary activity is producing goods or services related to (1) increasing use of renewal energy, (2) increasing efficiency of or conservation by electric utilities, (3) reducing greenhouse gas emissions, (4) surface water quality, or (5) increasing the use of biofuels.

Qualified taxpayer is an accredited investor under SEC Regulation D. This can be either a business entity (e.g., a small business investment company, bank, insurance company, and so forth) or a high-income or high-net-worth individual. SEC rules require an individual to either have a net worth of $1 million or to have had income of $200,000 in each of the last two years ($300,000 for a married couple). In addition, a control test and an income test apply: A qualified taxpayer can neither own more than 20 percent of the business nor receive more than 50 percent of the taxpayer's gross income from the businesses. If an individual is disqualified by either of these tests, a family member (spouse, sibling, or lineal ancestor or descendant) is also disqualified.

Qualified angel investment network fund is a passthrough entity (partnership, LLC, etc.) that invests in QSBs and has at least three separate investors, each of whom is a qualified taxpayer. Investors in the fund may be equity or debt investors. Family members and controlled entities are combined to determine whether the minimum of three investors is met.

Qualified investment is an equity investment in a qualified small business of at least $10,000 for a qualified taxpayer or $50,000 for a fund. This definition does not appear to be used in this section.

Subd. 2. Certification of QSBs. Authorizes businesses to apply to DEED for certification as a QSB. An application fee of $150 applies and these moneys are appropriated directly to DEED for its administrative and related costs. DEED is to post the application forms on the Internet. Applications must be made each taxable year. If a business receives an investment to which DEED allocates a tax credit, the business must file a certified small business report to DEED for the next two years. The report is due February 1 and failure to file the report results a $500 fine and revocation of certification.

Subd. 3. Certification of qualified taxpayers. Authorizes taxpayers to apply to DEED to be qualified taxpayers. An application fee of $350 applies and these moneys are appropriated directly to DEED for its administrative and related costs. Taxpayers must apply each year for certification. Taxpayers who receive a credit must file an annual report in each of the two years after claiming the credit.

Subd. 4. Certification of qualified angel investment network funds (QAINFs). Authorizes angel investment network funds to apply to DEED to become QAINFs. An application fee of $1,000 applies and these moneys are appropriated to DEED for its administrative and related costs. Applications must be made each taxable year. A QAINF must file an annual report to DEED each year when one of its members (investors) receives a tax credit and reports must also be filed in the next two years. The report is due February 1; failure to file the report results in revocation of the tax credits.

Subd. 5. Credit allowed. Allows a qualified taxpayer or QAINF a credit in the amount determined in the DEED certification. Total certifications are limited to:

- $10 million each for tax years 2010 and 2011
- $12 million per tax year for later years

Any unused part of the limit from one year carries forward to the next. Applications must be made for the credit to DEED. Credits are awarded on a first-come-first-served basis. Applications filed on the same day that exceed the remaining dollar limit are granted proportionate allocations.

Investments must be made within 60 days of receiving an allocation. If the investor does not meet this deadline, the credit allocation is revoked. Recipients of allocations must notify DEED of the failure to satisfy the 60-day deadline within 5 business days.

DEED is required to notify the commissioner of revenue of allocations and revocations of allocations of the credit.

Subd. 6. Annual reports. Requires qualified taxpayers, QSBs, and QAINFs to file annual reports for each of the three years after receiving a credit. A $100 filing fee applies. The contents of the reports are specified as:

QSB report: Business must certify that: (1) it has a Minnesota headquarters, (2) 51 percent of its employees and payroll are in Minnesota, (3) it's engaged in innovation, and (4) it meets the minimum pay requirements.

Qualified taxpayer report: Taxpayers must certify that (1) they remain SEC accredited investors and do not violate the control tests and (2) they satisfy the three-year holding requirement (described below under section 2).

QAINF report: QAINFs must certify that (1) they continue to meet the requirements for a fund and (2) they satisfy the holding period requirement (described below under section 2).

Subd. 7. Rulemaking. Exempts DEED from the administrative procedure act requirements for rulemaking in administering the program.

Subd. 8. Report. Requires DEED to annually report to the legislature (by March 15 of each year) on:

- Number and amount of credits issued
- Recipients of credits
- Number and type of QSBs
- Total amount of investment generated by the credits
- Any other information relevant to administering the credits

Effective date: Investments made after July 1, 2010, if the QSB and investors were certified by DEED.

2 **Small business investment credit.** Allows a 25-percent credit for investments in a QSB made during the taxable year with a maximum credit for any taxpayer of $125,000. The investment can only be made after the taxpayer/investor and QSB have been certified by DEED. The credit is limited to the regular and alternative minimum tax liability under either the individual income or corporate franchise tax. The credit cannot be used to reduce the minimum fee. A ten-year carryover of amounts in excess of liability is allowed. For investments made by passthrough entities (QAINFs), the credits are allocated in proportion

to the individuals' ownership share on the date the investment was made.

Required three-year holding period. Investors must hold their investments in QSBs for a three-year period. Failure to do so will require repayment of the credit or cancellation of unused allocations of credits. Exceptions are provided that allow dispositions before the end of the three-year period, if one of the following occurs:

- The investment becomes worthless
- 80 percent of the QSB's assets are sold
- The QSB itself is sold
- The QSB's stock begins trading on a public stock exchange

Transfer of credit. A taxpayer can sell or transfer the credit, if the taxpayer has not paid Minnesota tax for three taxable years and does not anticipate paying tax in the year the sale or transfer is made. Transfers may only be made to individuals who are SEC accredited investors based on their net worth. Only one transfer of a credit may be made and the transferee is subject to the rules under this section.

Audit powers. Eligibility for the credit is subject to audit by DOR, despite the certifications by DEED.

Effective date: Investments made after July 1, 2010, for tax year 2010 and later.