MOJO GUIDE TO THE MN ANGEL INVESTOR TAX CREDIT

Minnesota now has an Angel Investor Tax Credit (AITC, Minn. Stat. Sec. 116J.8737), which will be a great new tool to promote investment in innovative enterprise in Minnesota. Minnesota's Department of Employment and Economic Development (DEED) will be managing the tax credit application, approval and compliance process. Start here for info on DEED's AITC implementation status: http://bit.ly/9gT5X4 (DEED site on AITC application). DEED Applications/forms will be available summer 2010. Below is MOJO's detailed how-to guide for the AITC when it goes live.

HOW TO APPLY FOR THE CREDIT:

1. Both the business and investor (or fund) file separate certification applications
2. DEED separately accepts or rejects the certification applications of the business and the investor (or fund)
3. If certification applications for both the business and the investor (or fund) are accepted, the investor (or fund) then files a tax credit application with DEED
4. DEED accepts or rejects the investor's (or fund's) tax credit application
5. Investor (or fund) makes the investment, then reports this investment back to DEED
6. By Feb 1st of the following year, the business and the investor (or funds) file an annual report. Investors must file annual reports for three years following the year of the investment. The business must file annual reports for five years following the year of the investment—details below
7. Investors (or funds) must hold the investment for 3 years (with some exceptions); failure to hold for three years results in revocation and repayment of the credit—details below
8. Businesses must keep 51% of employees and 51% of payroll in Minnesota for 5 years after the year of the qualifying investment. If they do not, the business must repay the state for tax credits the investor received. The amount of repayment required is based on a sliding scale—details below
9. Both the business and the investor (or fund) must reapply for certification each year they accept/make qualifying investments. Re-application is required even if the business and investor (or fund) were approved in the previous year.

TAX CREDIT ALLOWED:

- Tax credit equal to 25% of the amount invested in a qualified business
- Credits are applied against Minnesota tax liability.
- Credits are refundable (i.e. taxpayer will get a cash refund from Minnesota if you do not have any Minnesota tax liability). This allows/encourages investments coming from out of state investors

INVESTOR QUALIFICATION:

- Minimum investment to qualify for tax credit: $10,000 in cash, made in a calendar year
  - The investment must be made in exchange for: (1) common stock, (2) a partnership or membership interest, (3) preferred stock, (4) debt with mandatory conversion to equity, or (5) an equivalent ownership as determined by DEED
- Maximum investment that qualifies for credits (per calendar year): $1,000,000 for a married couple filing joint returns, and $500,000 for all other filers (this translates to a maximum in credits

of $250,000 for a married couple and $125,000 for all other filers). Separate investments in multiple companies each count towards this limit.

- The investor must certify to only invest in a transaction that is exempt under section 80A.46, clause (13) or (14), or in a security registered under section 80A.50, paragraph (b).
- The investor cannot receive more than 50% of their gross annual income from the qualified business.
  - For a married couple, they cannot collectively receive more than 50% of their gross annual income from the qualified business.
  - An investor's family member is also disqualified if the investor makes more than 50% of their gross annual income from the qualified business
    - Family member is defined by Internal Revenue Code, section 267(c)(4)

INVESTOR FUND QUALIFICATION:

- The fund must invest, or intend to invest in qualified small businesses
  - Minimum investment to qualify for tax credit: $30,000 in cash, made in a calendar year
  - The investment must be made in exchange for: (1) common stock, (2) a partnership or membership interest, (3) preferred stock, (4) debt with mandatory conversion to equity, or (5) an equivalent ownership as determined by DEED
- Be a pass through entity.
  - "Pass-through entity" means a corporation that for the applicable taxable year is treated as an S corporation or a general partnership, limited partnership, limited liability
    partnership, trust, or limited liability company and which for the applicable taxable year is
    not taxed as a corporation under chapter 290.
- Have at least 3 separate investors, all of whom must be able to qualify as an individual investor (i.e. meet all the requirements for an individual investor, as listed above)
- Investments in the fund may be equity investments or notes that pay interest or other fixed amounts, or any combination of both

BUSINESS QUALIFICATION:

- Operating less than 10 years
- Received no more than $2,000,000 in "private equity investments"
- Maximum investment that will qualify for tax credit: $4,000,000 from all sources over all taxable years (i.e. one business cannot generate more than $1M in credits)
- Headquartered in Minnesota
- Have fewer than 25 employees
  - employees of a parent company or subsidiary are included in this number; see Minn. Stat. Sec. 290.17(4)
- Have 51% of your employees working in Minnesota
- Have 51% of total payroll is paid or incurred in Minnesota
- Employees must be paid annual wages of at least 175 percent of the federal poverty guideline for the year for a family of four
  - for 2010, this level is a minimum of $38,587.50 in annual wages for each employee
  - this requirement is reduced proportionately for employees who work less than full-time,

    - this requirement does not apply to an executive, officer, board member, or to any employee who owns, controls, or holds power to vote more than 20 percent of the outstanding securities of the business
- The business cannot be disqualified by Minn. Stat. Sec. 80A.50(b)(3) [disqualification from making a small corporation security offering in Minnesota]
- Business must be engaged in, or committed to engage in, innovation in Minnesota. This is defined as having a "primary business activity" in one of the following three categories:
    - (1) using proprietary technology to add value to a product, process, or service in a qualified high-technology field;
    - (2) researching or developing a proprietary product, process, or service in a qualified high-technology field; or
    - (3) researching, developing, or producing a new proprietary technology for use in the fields of agriculture, tourism, forestry, mining, manufacturing, or transportation;
    - "qualified high-technology field" includes aerospace, agricultural processing, renewable energy, energy efficiency and conservation, environmental engineering, food technology, cellulosic ethanol, information technology, materials science technology, nanotechnology, telecommunications, biotechnology, medical device products, pharmaceuticals, diagnostics, biologicals, chemistry, veterinary science, and similar fields
    - "Proprietary technology" means the technical innovations that are unique and legally owned or licensed by a business and includes, without limitation, those innovations that are patented, patent pending, a subject of trade secrets, or copyrighted.

- The following businesses are specifically excluded from the tax credit:
    - real estate development,
    - insurance,
    - banking,
    - lending,
    - lobbying,
    - political consulting,
    - information technology consulting,
    - wholesale or retail trade,
    - leisure,
    - hospitality,
    - transportation,
    - construction,
    - ethanol production from corn, or
    - professional services provided by attorneys, accountants, business consultants, physicians, or health care consultants;

<u>THREE-YEAR HOLDING-PERIOD FOR INVESTOR</u>:

- If the investor (or fund) fails to hold the investment for 3 years, the credits are revoked and must be repaid by the investor within 30 days; the investor must also file an amended tax return
- Exceptions to the 3 year holding period

    - If the investment becomes worthless
    - If 80% of the business's assets are sold
    - If the business is sold
    - If the business starts trading on a public exchange

FIVE-YEAR REQUIREMENT TO KEEP 51% OF EMPLOYEES/PAYROLL IN MINNESOTA:

- If the business does not maintain 51% of employees and 51% of payroll in Minnesota for the 5 years following the investment, the business must repay the credits that the investor received within 30 days; the business must also file an amended tax return
- The repayment by the business is pro-rated as follows:
    - Year after investment made — Percentage of credit that must be repaid

Year after investment made	Percentage of credit that must be repaid
First	100%
Second	80%
Third	60%
Fourth	40%
Fifth	20%
Sixth or later	0%

DEADLINES:

- BOTH the business and the investor (or fund) must have applied for (and received) certification from DEED prior to making a qualified investment
    - Investors who are not "accredited investors" must apply for certification within 30 days after making the qualified investment.
        - "accredited investor" is defined in Regulation D of the Securities and Exchange Commission, Code of Federal Regulations, title 17, section 230.501, paragraph (a)

- For 2010, certification applications (for businesses, investors, and funds) must be on DEED website by August 1st
    - starting in 2011, certification applications must be on DEED's website by Nov. 1st of the preceding year
    - DEED has 30 days from receipt of a certification application to approve, reject, or request further information; application are deem rejected if no decision is made by DEED within 30 days of receipt. Rejected applicants may reapply.
- For 2010, tax credit applications (for investors and funds) must be on DEED's website, and DEED must begin accepting them, by Sept 1st. **The earliest an investment can be made is July 1, 2010**.
    - starting in 2011, tax credit applications must be on DEED's website by Nov. 1st of the preceding year
    - DEED has 15 days from receipt of a tax credit application to approve or reject the application; if the accepted, DEED will allocate the credits.
    - The investor (or fund) must make the investment within 60 days of the allocation, the investor (or fund) will report to DEED once the investment has been made
    - After receiving notification, DEED will issue tax credits to the investor (or fund); credits are issued for the taxable year in which the investment is made

- Credits are available on a first-come, first-serve basis. There is $11M available for 2010 and $12M available each year from 2011 through 2014. The law sunsets (ends) this tax credit after 2014 [new legislation would be required to extend the tax credit].
    - Tax credit applications received the same day are treated as having been filed contemporaneously. If the amount of tax credits applied for exceeds the remaining appropriation available, credits are allocated on a pro rata basis

<u>FEES & ANNUAL REPORT</u>:

- Certification application fee for BUSINESS: $150 (certification good for one calendar year only)
- Certification application fee for INVESTOR: $350 (certification good for one calendar year only)
- Certification application fee for FUND: $1,000 (certification good for one calendar year only)
- Annual reports are due by Feb. 1st of the year following the investment
- Annual report filing fee (for businesses, investors, and funds): $100
    - Businesses must file annual reports for 5 years following the year of the investment
        - If a business ceases all operations and becomes insolvent, it should file an annual report, but is exempt from paying the fee and from reporting in subsequent years
    - Investors and funds must file annual reports for 3 years following the year of the investment
    - There is a $500 fine for failing to file an annual report
- Annual report from the business must certify that the business maintains
    - Headquarters in MN
    - 51% of employees and 51% of payroll in MN
    - That the business meets the minimum pay requirements (as above; pay = 175% of poverty level for a family of four)
    - That the business remains engaged in, or committed to engage in, innovation in Minnesota (as defined above)
- Annual report from the investor (or fund) must certify that the investor (or fund) remains invested in the business

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