Minnesota's New Small Business Investment Tax Credit aka "The Angel Investment Tax Credit"

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On April 1, 2010, Minnesota Governor Tim Pawlenty signed into law the Small Business Investment Tax Credit, also known as the "Angel Investment Tax Credit." The new law, long sought after by Minnesota's economic development and investment community, creates a credit against Minnesota income taxes equal to 25% of a taxpayer's investment in a "qualified small business."

Background

The State of Minnesota faces stiff competition from all of its neighbors when it comes to business expansion and relocation. South Dakota has a history of generous state subsidies to businesses choosing to relocate or expand there, and Minnesota's other neighbors - North Dakota, Iowa and Wisconsin - all have some sort of angel investment tax credit. With the growing ranks of Minnesota individuals choosing to be their own boss and launch a new business venture, the Minnesota Legislature acted quickly this session to pass a similar tax credit to spur on economic development within the State.

Overview

Minnesota's Angel Tax Credit is relatively straightforward: qualified investors are eligible for a 25% individual tax credit for qualified investments made to qualified small businesses. The maximum credit is $125,000 per year per individual or up to $250,000 for those married and filing jointly. Additionally, the aggregate amount of tax credits allowed is $11 million in 2010 and $12 million per year in 2011 through 2014, and credits are granted on a first come, first served basis.

Qualifications

The key definitions in the new credit are the definitions of "qualified investor,","qualified investment," and "qualified small business." The Minnesota Department of Economic Development ("MNDEED") is charged with making these qualifications and the new law outlines the criteria which MNDEED will use in making such qualifications.

Qualified Investor

To be "qualified," an investor is required to certify that his or her investment will be made in a transaction registered under Minnesota's small corporate offering registration, or exempt from registration under the institutional investor exemption or limited offering exemption. The tax credit is unavailable, however, to an investor, or member of an investor's family, who derives more than 50% of his or her annual gross income from the qualified small business in which he or she proposes to invest.

Regarding qualified funds, each fund is required to certify that it invests in qualified small businesses, is organized as a pass-through entity, and has at least three separate investors, all of whom are "qualified investors."

Out-of-state investors will be entitled to a refund in the amount of the credit, regardless of the lack of Minnesota taxable income, if the investor files a return in Minnesota.

Qualified Investment

To be a "qualified investment," the investment must be in cash, in exchange for equity securities (including common stock or convertible securities), and for a minimum of $10,000.00 (for a qualified investor) or $30,000.00 (for a qualified fund).

Qualified Small Businesses

Three types of businesses will qualify for angel investments under the new tax credit law: (1) those using proprietary technology to add value to a product, process or service in a qualified high-technology field; (2) those researching or developing a proprietary product, process or service in a qualified high-technology field; and (3) those researching, developing or producing a new proprietary technology for use in agriculture, tourism, forestry, mining, manufacturing or transportation. In addition, qualifying businesses must be headquartered in Minnesota and have fewer than 25 employees, with at least 51% of the workers and total payroll based in the state. Businesses must have been operating for no more than 10 years and cannot have received previous equity investments exceeding $2 million. Specifically prohibited from eligibility are investments in businesses engaged in real estate and financial services, most consulting businesses, wholesale or retail trade, professional services, transportation, construction, and ethanol production from corn.

Other Restrictions and Conditions

If the investment is not held by a qualified investor or qualified fund for at least three years, any credit taken must be repaid, and any unused credits are revoked. This three-year holding period does not apply if the investment becomes worthless, or if the qualified small business or more than 80% of its assets are sold, or if the common stock of the qualified small business begins trading on a public exchange.

Once qualified, qualified small businesses, investors and funds face ongoing reporting requirements to MNDEED. This includes an annual report and a $100 fee affirming that they continue to meet the qualification requirements. This annual report must be filed for three years following the investment for qualified investors and qualified funds and five years for a qualified small business. Failure to file a report results in a fine and revocation of the credit. In addition, a portion of the credit is revoked and subject to repayment if the qualifying small business can no longer certify that at least 51% of its employees are employed in Minnesota or that 51% of its total payroll is paid in Minnesota.

Conclusion

Time will tell as to whether Minnesota's Angel Tax Credit proves to spur on business growth. Nonetheless, the enactment of the credit represents a significant and positive development in Minnesota's economic development efforts.