

Angel Investor Tax Credit

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Georgia House Bill 1069 was signed into law by Governor Perdue early in June. Section Two of the new law, known as the “Angel Investor Tax Credit,” provides for a Georgia tax credit of up to \$50,000 annually for investors of early-stage, start-up companies in Georgia. Angel investors provide capital for start-up businesses in exchange for equity or convertible debt, and unlike venture capitalists, typically invest their own funds.

Access to early-stage growth in young companies is often difficult to obtain, and the purpose of this tax credit is to encourage direct investment from individuals in high-tech businesses. It aims to expand the economy of Georgia by enlarging its base of wealth-creating business, thus increasing the number of quality and high-paying jobs. Additionally, it aims to attract qualified individuals to move to and work within Georgia, retain talented individuals educated in Georgia’s university systems within the state, and to support businesses seeking to commercialize technology invented and developed in Georgia’s universities.

The Credit

The credit equals 35 percent of the amount invested in the start-up company and is available for investments made in 2011, 2012, and 2013. However, the credit cannot be used until the second year following the year the investment is made. Investments can be made by individuals or pass-through entities that have no business operations and manage less than \$5 million in capital.

The aggregate amount of credit allowed against taxable income for any number of qualified investments is \$50,000 at the individual level annually. If the taxpayer does not have a large enough tax liability to use the entire credit, it may be carried forward for five years. In short, the annual maximum of \$50,000 can be obtained by investing \$142,857 into one or more eligible businesses per year. At this level, the credit will offset \$833,333 in Georgia taxable income.

<u>Angel Credit Recap:</u>			
	<u>Single Person per Year</u>	<u>Georgia Total per Year</u>	<u>Georgia Total for 3 Years</u>
Maximum investment	\$ 142,857	\$ 28,571,429	\$ 85,714,286
Maximum credit usage	\$ 50,000	\$ 10,000,000	\$ 30,000,000
Income to offset with credit	\$ 833,333	\$ 166,666,667	\$ 500,000,000

Qualifying Investors

Angel investors eligible for the credit must be “accredited investors” as defined by the SEC. This is limited to individuals who are obligated to pay Georgia income taxes or pass-through investment entities and manage \$5 million or less in capital. Venture capital funds, hedge funds, and commodity funds with institutional investors do not qualify.

Investments in the companies that qualify for the credit must be paid for in cash by a qualified investor to a qualified business in exchange for stock, an equity interest, or subordinated debt and cannot have been raised as a result of other tax incentive programs. Further, no commissions or other remuneration may be paid directly or indirectly for solicitation of the investment.

Qualifying Businesses

In order for a business to qualify as investment eligible under the credit, it must register with the tax commissioner. Upon approval, the business is considered eligible for investment for the credit for 12 months. To qualify, a business:

- Must be a corporation, LLC, or partnership located in Georgia
- Must be organized no more than 3 years before the investment is made
- Cannot be engaged substantially in retail sales, real estate and construction, professional services, gambling, natural resource extraction, investment activities and insurance, or activities where admission or membership is charged
- Must have its headquarters located in GA from the time the investment is made through the entire duration that an investor benefits from the credit
- Must employ 20 or fewer people at the time of registration
- Cannot have gross revenues that exceed \$500,000 in any prior fiscal year
- Cannot have obtained more than \$1 million in gross cash proceeds from issuing debt or equity instruments (does not include commercial loans)
- Cannot have utilized the GA film tax credit

Application and Approval

An original application must be filed by the qualified investor by June 30 of the year following the investment. Additionally, the qualified investor must submit an application between September 1 and October 31 of the year for which the credit is claimed. During this period, the credits will be approved for taxpayers up to the \$10 million annual limit. *If the annual limit is reached, the credits will be allocated to all timely applicants on a pro-rata basis.*

It is important to note that investors receiving the credit must follow certain provisions after the credits are obtained. Credits must be recaptured if the investor transfers any of the securities or subordinated debt received in the investment to another person or entity within two years of the transaction. Recapture is not triggered if the investor dies, transfers to a spouse incident to divorce, or if a merger, conversion, or sale of the business occurs where the investor does not receive cash or tangible property. Additionally, the credit must be recaptured if the qualified business redeems the investor's securities or pays principal on any subordinated debt within five years of the date the investment was made. Finally, the qualified investor or his/her immediate family may not participate in any operation of the business for compensation within two years of the date the investment was made. Compensation does not include stock or stock options.

Recap

The Angel Investor Tax Credit is a great move taken by the Georgia legislature to promote the development of start-up companies in the state. This measure, along the other credits and initiatives available to Georgia companies, confirm Georgia's enduring commitment to establish the state as the center of entrepreneurship in our region.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. Please do not hesitate to contact me, however, if you have any questions regarding this matter.

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Example of Credit Benefit

The following example shows the tax benefit to an angel investor from a \$100,000 investment, taking into account the eventual sale of the investment.

Company identified and qualified for Angel Tax Credit					
Angel invests in Qualified Company	\$100,000 in 2011				
Angel Credit rate	35%				
Tax credit for Angel	\$35,000 to be used in 2013-2015				
Credit can be used to offset	\$583,333 Taxable income from 2013-2015				
Assume in 2015 an Angel sells the investment for	<u>\$150,000</u>				
<u>Tax on Gain:</u>	Capital Gain with Credit	Capital Gain Tax Rate	Tax with Credit	Capital Gain without Credit	Tax without Credit
Federal capital gain	\$ 50,000	15%	\$ 7,500	\$ 50,000	\$ 7,500
State capital gain (Credit is added back)	\$ 85,000	6%	<u>\$ 5,100</u>	\$ 50,000	<u>\$ 3,000</u>
			<u>\$ 12,600</u>		<u>\$ 10,500</u>
<u>Analysis of transaction:</u>	<u>With Credit</u>	<u>Without Credit</u>	<u>Difference</u>		
Investment by Angel	\$ 100,000	\$ 100,000	\$ -		
Plus gain (sale price less investment)	\$ 50,000	\$ 50,000	\$ -		
Plus tax credit	\$ 35,000	\$ -	\$ 35,000		
Less tax on gain	<u>\$ (12,600)</u>	<u>\$ (10,500)</u>	<u>\$ (2,100)</u>		
	<u>\$ 172,400</u>	<u>\$ 139,500</u>	<u>\$ 32,900</u>		
<u>Recap:</u>					
Credit	\$ 35,000				
Tax cost of credit (Credit x 6%)	<u>\$ (2,100)</u>				
Credit benefit, net of tax	<u>\$ 32,900</u>				