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Abstract: Recent legislation provides a tax credit for angel investors who invest directly in a qualified new business venture.

Angel Investment Tax Credit

New legislation provides a Wisconsin income tax credit to individual angel investors who invest in qualified early-stage businesses.

The angel investment tax credit is limited to 25% of an angel investor's total investment in a single qualified company up to a cap of $500,000 per investor per qualified company. The 25% credit must be divided evenly over two tax years, beginning with the year of the investment. For example, if an angel investor invests $100,000 in a qualified business in 2005, the investor may qualify to receive a $12,500 tax credit against his 2005 Wisconsin income taxes and another $12,500 tax credit against his 2006 Wisconsin income taxes for a total $25,000 tax credit for the investment.

To qualify for the tax credit, the investment must be made in a "qualified new business venture" that is certified by the Wisconsin Department of Commerce and meets all of the following conditions:

- Headquartered in Wisconsin;
- Employs less than 100 employees, of which at least 51% are employed in Wisconsin;
- Operated in Wisconsin for less than 7 consecutive years;
- Received less than $1,000,000 in prior investments that qualified for angel investment tax credits;
- Engaged in manufacturing, agriculture, or processing or assembling products and conducting research and development or developing a new business product or process; and
- Not engaged in real estate development, insurance, banking, lending, lobbying, political consulting, wholesale or retail trade, leisure, hospitality, transportation, construction, or professional services provided by attorneys, accountants, business consultants, physicians or health care consultants.

A qualified new business venture may be incorporated or organized in Wisconsin or any other state, including Delaware, so long as its headquarters and at least 51% of its employees are in Wisconsin.

The tax credits will be available for investments made on or after January 1, 2005. The law also limits the amount of tax credits available each year to all investors under the program to $3 million, which means that the aggregate amount of angel investments that may qualify each is year is limited to $12 million (25% of $12 million total invested is $3 million in tax credits). The legislation does not address what will happen if and when these caps are reached within any tax year. This ambiguity, along with others, will need to be addressed by new administrative rules, to be promulgated by the Department of Commerce in the coming months (before October 31, 2004), to implement this tax credit program.

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Angel Investment Tax Credit (continued)

A second ambiguity to be resolved by the new rules will be precisely how the $1 million cap per company on prior qualified investments will operate. Will the tax credit be available, for example, if an otherwise qualified new business venture has previously received $500,000 in prior qualified investments and angel investors plan to invest an additional $700,000 in the current round? And, if the tax credit will be available for at least the first $500,000 of the $700,000 in the second round (up to the $1 million cap), will the tax credits be apportioned pro rata among all the angel investors in that round or on a first-come, first-served basis for offerings that remain open for a period of time? According to staff at the Department of Commerce, this and other issues will be addressed by the new rules.

> ***...The tax credits will be available for investments made on or after January 1, 2005.***

A third issue to be resolved in the rulemaking process is whether investments made by individual angel investors through a limited liability company or other business entity formed for the sole purpose of making a single investment will qualify for the tax credits. Under the statutory language, the tax credit is available for a "***claimant's*** bona fide angel investment made ***directly*** in a qualified new business venture." (Emphasis added). Although the definition of "bona fide angel investment" includes investments made by "a network of individuals," the term claimant is limited to an "individual." Together with the requirement that the claimant's investment be made "directly" in a qualified company, this language could preclude angel investors from claiming the tax credits where they invested indirectly through an LLC or other entity. Staff at both the Department of Commerce and the office of one of the bill's co-sponsors have indicated that this was not the intent of the legislation and that this ambiguity should be resolved by the Department of Commerce rules.

Until the Department of Commerce issues final rules clarifying the issues discussed above, angel investors who want to qualify for these tax credits should consider (a) requiring that the total of the current offering, together with any prior investments that qualified for the tax credit, not exceed $1,000,000; and (b) structuring the transaction to be a direct investment by each angel investor and not invest through a limited liability company or other business entity. Investors should also require that the company provide them with a current copy of the Department of Commerce certification that the company meets the requirements listed above for a qualified new business venture. ◆

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