

MINNESOTA'S ANGEL TAX CREDIT

June 2019

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INTRODUCTION

Minnesota has a long tradition of supporting the growth of early stage businesses. Today's economy requires us, now more than ever, to provide business owners with the resources necessary to grow their businesses. One way to help businesses grow is to facilitate equity investments.

Minnesota's Small Business Investment Tax Credit (the "Angel Credit"), codified at Minn. Stat. § 116J.8737, is intended to encourage equity investment in early stage, technology-based businesses and encourage job creation by providing tax incentives to investors making investments in these innovative companies. The credit encourages investment in start-up companies that are focused on developing high technology, using new proprietary technology, or developing a proprietary product, process or service in a limited number of fields.

More than twenty-five states have established investment incentive programs similar to Minnesota's. The structure and operation of each program differs depending on the particular laws of each state. Minnesota's Angel Credit program is structured as a dollar-for-dollar reduction of the recipient's Minnesota income tax liability.

Before an investor can receive credits under the program, there are a number of eligibility requirements that must be met and a number of procedural steps that must be taken – both by the business and by the investors involved. Many of the requirements and steps are not intuitive. This booklet is designed to provide businesses and investors with a basic understanding of how the Angel Credit works.

The 2019 Legislature amended the Angel Tax Credit program. The key changes are described below:

- The program was reinstated after a lapse in 2018. It is authorized to operate in 2019 and 2021.
- The amount of credits available for 2019 and 2021 is \$10 million per year, with no credits available for 2020. 50 percent is reserved for 3 types of businesses: those headquartered outside the Twin Cities seven-county metropolitan region and those majority-owned and managed by women or minorities.
- The minimum investment amount was reduced from \$10,000 to \$7,500 for investments by a qualified investor in businesses located in greater Minnesota or veteran, minority, or women-owned businesses.
- The fine for filing a late annual report was reduced from \$500 to \$100. Failure to file an annual report by April 1 by an investor or fund can cause an allocated credit to be revoked, requiring repayment by the investor, and failure to file by a business can require that the business repay the credits awarded to its investors.

The information provided in this booklet is not intended as, and should not be relied upon as, legal advice. Individuals and business entities should always seek the advice of qualified legal counsel in all matters relating to obtaining and using the Angel Credit.

CHAPTER 1 KEY DEFINITIONS

- **Angel Credit:** A tax credit issued to a Taxpayer for making Qualified Investments. The investments may be made directly by the Taxpayer as an Angel or indirectly, through a Qualified Fund in which the Taxpayer is an equity owner.
- **Taxpayer:** The individual receiving Angel Credits in connection with a Qualified Investment. A Taxpayer may be: (1) a natural person who is an Angel; (2) an equity investor in a Qualified Fund; or (3) an individual beneficiary of a revocable trust (but not the beneficiary of an irrevocable trust).
- **Angel or Qualified Investor:** A natural person who has been certified (or, in certain circumstances, will be certified) as eligible to make Qualified Investments. The terms Angel and Qualified Investor have the same meaning.
- **Qualified Fund:** An investment fund or other investment entity that is certified as eligible to make Qualified Investments because it (1) invests in, or intends to invest in, Qualified Small Businesses; (2) is recognized as a Pass-Through Entity for tax purposes; and (3) has at least three separate individual investors (and at least three of its investors intend to make use of Angel Credits in connection with its investment).
- **Pass-Through Entity:** An entity that is generally not subject to income tax but as to which any taxable income is taxable directly to its equity owners. These generally include a corporation

that has elected to be treated as an S corporation, a general partnership, a limited partnership, an irrevocable trust, or a limited liability company that has elected to be treated as a partnership. Revocable trusts are not Pass-Through Entities.

- Qualified Small Business or QSB: A small business that meets the program’s eligibility requirements (including requirements concerning the nature of its business, its operating history and its funding history) and that is certified as eligible to receive Qualified Investments from Angels and Qualified Funds.
- Qualified Investment: A cash investment in a QSB in exchange for equity in the QSB. The investment must meet a number of additional requirements.
- Unitary Group: Two or more entities that are required under the Minnesota tax laws to file a combined tax return based upon common ownership, operation or activities, or otherwise. Generally, related entities which are required to file consolidated tax returns are treated as a Unitary Group. Parent entities, subsidiary entities and “sister” entities are usually included.
- DEED: Minnesota’s Department of Employment and Economic Development. See DEED’s [Angel Tax Credit](#).
- Greater Minnesota: The area outside the seven-county Twin Cities metropolitan area [outside the counties of Hennepin, Ramsey, Washington, Scott, Dakota, Anoka, and Carver].
- Greater Minnesota Business: A business whose headquarters is located in Greater Minnesota, has at least 51 percent of its employees employed in Greater Minnesota, and has at least 51 percent of its total payroll paid or incurred in Greater Minnesota.

- Intern: A student at an accredited institution of higher education, or a recent graduate within the past six months, who is employed (for nine months or less) at a small business in a temporary position that provides training and experience in business activities.
- Liquidation Event: Conversion of an investment for cash, cash and other consideration, or any other form of equity or debt interest.
- Minority Group Member: A United States citizen who is Asian, Pacific Islander, Black, Hispanic or Native American.
- Minority-owned Business: A business for which one or more minority group members own at least 50 percent of the business and manage the business and control daily business operations.
- Officer: A person elected or appointed by the board of directors to manage the daily operations of the business.
- Principal: A person having authority to act on behalf of the business.
- Women-owned Business: A business for which one or more women own at least 50 percent of the business and manage the business and control daily business operations.
- Veteran: a citizen of the United States or a resident alien who has been separated under honorable conditions from any branch of the armed forces of the United States after having served on active duty for 181 consecutive days or by reason of disability incurred while serving on active duty.
- Veteran-owned Business: A business for which one or more veterans own at least 50 percent of the business and manage the business and control daily business operations.

CHAPTER 2 HOW THE CREDIT WORKS

Minnesota's Angel Credit is a refundable tax credit equal to 25 percent of a qualified investment in a Minnesota small business.

Qualified Investments may be made by an individual investor (sometimes referred to as an Angel or a Qualified Investor) or by a qualified investment fund (referred to as a Qualified Fund). When an Angel makes a Qualified Investment, the individual making the investment will receive the Angel Credits. When a Qualified Fund makes a Qualified Investment, the owners of the fund will receive the Angel Credits in amounts proportional to the individual's ownership of the Qualified Fund. Regardless of whether the investment is made by an Angel or by a Qualified Fund, the resulting tax credits are awarded to individual Taxpayers.

Angel Credits are applied against and reduce the Minnesota income tax liability of the recipient Taxpayer. If a Taxpayer's Angel Credits exceeds his or her Minnesota income tax liability, then the Taxpayer will be entitled to a tax refund equal to the difference. Taxpayers need not be Minnesota residents. The refundable nature of the credit encourages investment in Minnesota business by out-of-state investors.

An individual Taxpayer is eligible to claim up to \$125,000 of Angel Credits each year (for up to \$500,000 of Qualified Investments). Taxpayers filing joint tax returns are eligible to claim up to \$250,000

of Angel Credits each year (for up to \$1 million of Qualified Investment). Credits allocated to a Taxpayer for investments through Qualified Funds are included in calculating these annual maximums. Taxpayers are not subject to any lifetime maximum amount of Angel Credits.

Key Angel Credit Requirements

There are three key requirements for Angel Credits under the program:

- Qualified Small Business (QSB),
- Qualified Investor / Qualified Fund, and
- Qualified Investment.

Qualified Small Business (QSB)

Angel Credits are only available for investments in Qualified Small Businesses (or QSBs). A Minnesota small business that meets the program requirements may apply to DEED to be certified as a Qualified Small Business. There are a number of criteria that a small business must meet before DEED will be able to certify the business as a Qualified Small Business.

The foremost requirement is that the business must be engaged in, or committed to engage in, “innovation” by researching, using or developing proprietary technology in a qualified high technology field or in one of six other specifically designated fields, or the business must be researching or developing a proprietary product, process or service in one of those fields.

The business must also meet criteria concerning its employees (location and pay), limits on how long the business has been in operation, its service contracts, limits on its prior equity funding history, and a number of additional requirements. QSBs are not subject to any annual maximum of Angel Credits generated. They are, however, subject to a lifetime maximum of generating \$1 million of credits (equal to receiving a lifetime maximum of \$4 million of Qualified Investments).

After a Qualified Investment is received, the QSBs is obligated to file certain reports and meet ongoing requirements for five years. Failure to comply with certain of these requirements will require the QSB to amend its Minnesota tax return within 30 days of a disqualifying event and pay a tax equal to all or a portion of Angel Credits allocated to its investors. The amount of tax is 100 percent of credits during the year of investment and the next calendar year, then is reduced by 20 percent each calendar year. A QSB's failure to meet its post-investment requirements does not affect the Taxpayer's receipt of credits.

Qualified Investors / Qualified Funds

Angel Credits are available to Taxpayers for person, direct investments or for indirect investments, made by qualifying funds that are owned by individual Taxpayers.

Qualified Investors

Angel Credits are available to individual investors (known as Angels or Qualified Investors) in connection with a Qualified Investment. Individual investors must apply for and receive a certification from DEED in connection with a Qualified Investment. When an Angel makes a direct Qualified

Investment in a QSB, the individual Angel receives the corresponding Angel Credit.

There are no income or net worth tests that an individual investor must meet in order to be certified as a Qualified Investor. While many Qualified Investors will be obligated to obtain certification from DEED prior to making a Qualified Investment, Angels that are not accredited investors (within the meaning of the federal securities laws) may file certification requests (and pay the corresponding fee) either before making a Qualified Investment or within 30 days after making a Qualified Investment.

Qualified Funds

Certain investment funds may apply for and be certified by DEED as Qualified Funds under the program. When a Qualified Fund makes a Qualified Investment, the individual owners of the Qualified Fund receive the resulting Angel Credits (rather than the fund receiving the Angel Credits).

To be eligible for certification as a Qualified Fund, the investment fund (1) must be organized and treated as a disregarded or pass-through entity for tax purposes (a Disregarded Entity) and (2) must be owned by at least three individuals, who intend to make use of the resulting Angel Credits.

Qualified Investment

A Qualified Investment must be a cash investment made in exchange for equity in the QSB. Equity of the QSB may include: common stock, partnership or membership interests, preferred stocks or mandatorily convertible debt meeting certain specific requirements. In order for convertible debt investments to be treated as equity and qualify under the program, the debt must contain mandatory conversion provisions and be convertible without any further action by or consent from the Angel investor. These requirements are more fully discussed in Chapter 6, Qualified Investments.

Qualified Investments are subject to minimum investment restrictions. To qualify, an investment in a QSB must exceed the applicable minimum investment requirement.

- An Angel's investment in the QSB must be at least \$10,000 in a calendar year, except for QSBs that are qualified greater Minnesota businesses or that are women, minority, or veteran-owned, in which case the investment must be at least \$7,500.
- A Qualified Funds' investment in the QSB must be at least \$30,000 in a calendar year.

The Angel Credit Process

Angels, Qualified Fund and QSBs must all meet the program's requirements and obtain certifications from DEED before Qualified Investments can be completed (with the exception that certain Angels may obtain certification post-transaction). Applications for certification are submitted to DEED. The certification process entails submitting an application form along with the applicable fee. Certifications will be granted or denied based on whether the applicant meets the program's requirements. Periodically, DEED will publish a list of the Angels, Qualified Funds, and QSBs that it has certified in that year. DEED publishes the list on its website. The list identifies Angels and Qualified Funds by name but does not provide contact information or any other information regarding these individuals or entities. For Qualified Small Businesses, DEED may include basic contact information and descriptions of each Qualified Small Business (as permitted by the statute).

Certification of the business and investors are only part of the Angel Credit process. Before a Qualifying Investment will receive credits, the business and investors must apply to receive an allocation of available Angel Credits for the subject investment.

Angel Credits are allocated by DEED to specific investment transactions, from a pool of available credits. For 2019 and 2021, the Legislature has approved a pool of \$10 million of available credits, with 50 percent reserved for three types of QSBs: those headquartered outside the Twin Cities seven-county metropolitan region and those majority-owned and managed by women or minorities. If this \$5 million in credits is not allocated by September 30, those credits become available for investment in any QSB. Requests for an allocation of credits must be filed and approved by DEED prior to completion of the corresponding Qualified

Investment. There is no fee required for allocation requests. Allocation requests may be filed only after QSBs, Angels and/or Qualified Funds have received the required DEED certifications. Allocation requests that are submitted before the date that required certifications are issued will be treated as though filed on the date that the required certifications are issued. DEED must approve or reject each allocation request within 15 days of its receipt. Credits are allocated in the order that allocation requests are filed with DEED. All allocation requests filed on the same day are deemed filed simultaneously, and, if allocation requests filed on the same day exceed remaining available credits, the remaining credits are allocated on a pro-rata basis to those requests.

Qualified Investments must be completed within 60 days of the date Angel Credits are allocated, or by December 31, whichever comes sooner. Failure to complete the transaction within this period results in cancellation of the allocation. Angels and Qualified Funds must promptly notify DEED after completing a Qualified Investment.

At the end of the year, DEED will issue a credit certificate directly to each Taxpayer. The Taxpayer credit certificate will include credits for direct investments by the Taxpayer as an Angel, along with the Taxpayer's proportionate share of investments made by the Taxpayer's Qualified Funds. Credit certificates will be filed with the Taxpayer's Minnesota tax return, together with a Form M1REF "Refundable Credits."

Annual reports to DEED are required to demonstrate that eligibility requirements are being maintained. Failure to comply with post-investment requirements may result in a loss of the credit, requiring immediate repayment of the credits by the Taxpayer, or may result in a tax to the QSB equal to some or all of the credit received by its investors.

Angel Credits are subject to recapture. Qualified Investments must be held by investors for a three-year holding period. The three-year period is computed as (1) the remainder of the calendar year in which the investment is made plus (2) the following two calendar years. Failure to satisfy this requirement will result in the credits being revoked. If credits are revoked, each Taxpayer must file an amended Minnesota tax return for the year in which the credit was issued and the credit must be repaid by the Taxpayer within 30 days of revocation.

CHAPTER 3 QUALIFIED SMALL BUSINESSES (“QSBs”)

A company seeking allocation of Angel Credits for its investors must be certified by DEED as a Qualified Small Business (QSB) before receiving the corresponding investment. QSB certification may be obtained by submitting an online application to DEED along with a \$150 application fee, also payable online. The link to the application form is available on DEED’s website. Certification as a QSB only qualifies the business as eligible to engage in credit-generating transactions. It does not mean that any credits have been allocated for investments in the company. The credit allocation process is a separate step, discussed in Chapter 7, Allocations and Timetable.

Within 30 days of receiving an application for certification, DEED must grant certification, reject the application or request additional information. If DEED requests additional information, then DEED must certify or reject the application within 30 days of its receiving the requested additional information. The QSB application fee is not refundable (except that if an application is neither certified nor rejected within 30 days, then it will be deemed rejected and the fee may be refunded). Rejected applicants for QSB certification may reapply.

Certification is valid for the calendar year in which the certification was obtained. A new certification is required for each calendar year that the company wishes to qualify investments for additional credits.

50 percent of the available tax credits are reserved for investments in three types of QSBs:

1. Greater Minnesota-located (those headquartered outside the Twin Cities seven-county metropolitan region [outside the counties of Hennepin, Ramsey, Washington, Scott, Dakota, Anoka, and Carver] and whose employee count and payroll is at least 51 percent in Greater Minnesota), and
2. Women-owned (a business for which one or more women own at least 50 percent of the business and manage the business and control daily business operations), and
3. Minority-owned (a business for which one or more minority group members own at least 50 percent of the business and manage the business and control daily business operations).

A minority group member is defined as a United States citizen who is Asian, Pacific Islander, Black, Hispanic or Native American.

If the reserved credits are not allocated by September 30, those credits become available for investments in any QSB.

Once investment in a company results in the issuance of credits, there are a number of ongoing, post-investment requirements that the QSB must meet. Failure to remain in compliance with the ongoing, post-investment requirements could result in a tax on the company up to the amount of credits allocated to its investors. The QSB's failure to meet the ongoing requirements do not result in a tax on, or recovery of the credit from, Taxpayers.

In order to receive certification from DEED as a QSB, a number of conditions must be satisfied.

The Innovation Requirement

The company must be “engaged in” or “committed to engage in “innovation” in Minnesota with at least one of the following categories as its “primary business activity:”

- Category A. Using proprietary technology to add value to a product, process or service;
- Category B. Researching or developing a proprietary product, process, or service; or
- Category C. Researching, developing, or producing a new proprietary technology.

Merely engaging in or committing to engage in innovation is not adequate. The innovation activities must be the company’s primary business activity. While sources of revenue and the nature of a company’s expenses are good indicators of a company’s primary business activities, they are not the only factors to consider. Other factors that should be considered to consider include, without limitation: how the company holds itself out to the public, how the company characterizes itself in contexts other than the QSB process, the company’s uses of investment proceeds, the number of personnel devoted to the activity, as well as other factors. The requirement that the company be engaged in innovation is an ongoing requirement. Failure to comply with the requirement after credit-generating investments have been made, however, does not result in loss of the credit or require the QSB to pay any tax.

Companies whose primary business activities fall within Category A above must be operating or intending to operate in a qualified “high technology field.” These fields consist of the following:

- Aerospace
- Renewable energy
- Environmental engineering conservation
- Cellulosic ethanol
- Materials science technology
- Telecommunications
- Diagnostics
- Chemistry
- Biotechnology
- Agricultural processing
- Energy efficiency and conservation
- Information technology
- Food technology
- Nanotechnology
- Medical devices
- Pharmaceuticals
- Biological
- Veterinary science
- Similar Fields

It should be noted that these fields are not defined in the statute. As a result, DEED must exercise its judgment when reviewing applications for certification. The “similar fields” designation is a recognition that technology changes over time.

Companies whose primary business activities fall within Category C, above, may be eligible for QSB certification if their new proprietary technology is for use in the following fields:

- Agriculture
- Forestry
- Manufacturing
- Mining
- Tourism
- Transportation

Companies whose primary business activities fall within Category B above, may either be operating in a high technology field or may be researching or developing a proprietary product, process, or service in one of the six fields listed immediately above. Thus a QSB need not have technology as its primary business activity at all.

Companies engaging in the business described below *are not eligible* for certification under Category A and Category B, even if their primary business activities are in a qualified “high technology field.”

- Real estate development
- Insurance
- Banking
- Lending
- Lobbying
- Political consulting
- Information technology consulting
- Professional services provided by attorneys, accountants, business consultants, physicians, and health care consultants
- Wholesale trade
- Retail trade
- Leisure
- Hospitality
- Transportation
- Construction
- Ethanol from corn

This ineligibility does not apply to a company whose primary business activities fall within Category C. For example, a company in the transportation industry would be eligible if its primary business activities fall within Category C but would be ineligible if its primary business activities fall within Category A or Category B.

Proprietary Technology

In order for a company to qualify as a QSB, its technology, product, process or service must be unique. “Unique” includes, without limitation, innovations that are patented, patent pending, the subject of trade secrets, or copyrighted. Additionally, it must be legally owned or licensed by the company. If it is used pursuant to a license from a third party, the license need not be exclusive.

Location Requirements

The company must be headquartered in Minnesota. There are no requirements concerning where the company was originally incorporated or formed (for example, a corporation formed under Delaware law with its headquarters and principal operations in Minnesota may qualify as a QSB). Companies headquartered in Greater Minnesota (that area outside the seven-county Twin Cities metropolitan area), and who have at least 51 percent of their employees and payroll in Greater Minnesota, and who have the value of least 51 percent of their service contracts performed in Greater Minnesota are eligible to receive investments whose credits are allocated from the credit pool reserved for Greater Minnesota-located businesses and women, minority, or veteran-owned businesses.

Companies that receive credit-generating investments must maintain their headquarters in Minnesota for at least five years following the year of investment. Failure to comply with this requirement does not result in a tax on the company or recovery of the credit from Taxpayers.

The company must meet the following requirements regarding location of its employees:

- 51 percent of the company’s employees must be employed in Minnesota; and
- 51 percent of the company’s payroll must be paid or incurred in Minnesota.

The number of employees deemed employed in Minnesota (and other states) is computed on a “full-time equivalent” basis. For example, two employees, each working 20 hours per week, are considered one full-time equivalent and count as one employee. Similarly, three employees, who collectively work 40 hours per week, also count as one employee.

Where payroll is deemed “paid or incurred” will be based on where the employees work, without regard to where they live. Wages paid to an Iowa resident working in Minnesota are deemed paid or incurred in Minnesota. Wages paid to a Minnesota resident working in Wisconsin are deemed paid or incurred in Wisconsin, even though subject to Minnesota income tax.

The payroll requirements are ongoing obligations and must be satisfied for periods following the investment. Failure to do so may result in a tax on the company up to 100 percent of the credit but will not result in a tax on or recovery of the credit from Taxpayers.

Similarly, the company must have at least 51 percent of the value of its service contracts related to its primary business activity performed in Minnesota. An exemption from this requirement can be made if the business certifies that such the services cannot be performed in Minnesota.

Limits on Operating History

To qualify as a QSB a company must be “in operation” for less than a stated number of years. There are two different years “in operation” limits: (1) a 20-year limit that is applicable to a select group of medical device and pharmaceutical companies, and (2) a 10-year limit that is applicable to all other companies. Determining which limit will be applicable to a particular company depends on the nature of the company’s business and operations.

20-Year Operating Limit – Medical Devices and Pharmaceuticals

A company that is engaged in the research, development, or production of medical devices or pharmaceuticals may qualify for a 20-year operating limit. In order to be eligible for the 20-year limit, the company’s medical devices or pharmaceuticals must require U.S. FDA approval before they can be used in the treatment or diagnosis of a disease or condition. Such a company may qualify for certification as a QSB until it has been in operation for more than 20 years.

10-Year Operating Limit – Other Businesses

The default operating limit on QSB certification is a 10-year operating limit. That is, a company that has been “in operation” for 10 years or less can qualify for certification as a QSB. A company that has been in operation for more than 10 years will not qualify (unless it otherwise qualifies for the 20-year limit described above).

Prohibited Persons

A company seeking QSB certification cannot be subject to any of the disqualifications from eligibility to conduct a Small Corporate Offering Registration pursuant to the Minnesota Securities Act. These disqualifications limit the ability of certain persons and the businesses with which they are associated from conducting a simplified public offering of securities. A copy of these disqualifications is attached as Appendix A. Although these disqualifications are patterned after the disqualifications for Regulation A offerings under the federal securities laws, they are not identical.

Prior Equity Funding Limits

The amount of private equity raised by the company prior to applying for certification as a QSB must be \$4 million or less. This amount is recalculated at the time of each year's application for certification as a QSB. All transactions in prior years are included, including those for which credits were issued, but transactions for which certification is currently being sought are not. Qualified Investments received after the date of certification but in the same year as the certification will not affect the company's status as a QSB for the remainder of that year. If the company submits an application for certification in subsequent years, then those investments will be included in assessing eligibility.

Each year's application for QSB certification continues to include equity raised in prior years, including equity for which Angel Credits were allocated.

In determining the amount of equity previously raised, funds received by the company from the sale of debt which is subject to mandatory conversion (i.e. automatically or at the election of the company without action by the debt holder) are included. This is true even if the mandatory conversion is subject to contingencies and even if the debt holder has the option to convert such debt into equity prior to the mandatory conversion date.

Funds received from the sale of promissory notes and other debt where the holder has the right to convert such notes or debts into equity of the company but which are not subject to mandatory conversion are not treated as equity. Once such notes are actually converted, such funds will be included as equity previously raised.

DEED will determine compliance with the prior funding limitation based upon financial statements submitted by the company in connection with its application for certification as a QSB. Financial statements are required of all companies seeking certification. If the company has audited financial statements, they should be submitted. If the company does not have audited financial statements, its application should include a statement to that effect and the company should submit unaudited financial statements. If a company is newly-formed, and has conducted no operations, it should submit a balance sheet and/or a cap table (showing dollar amounts, not just units) as of the most recent practicable date showing equity raised by the company.

A business that has issued securities traded on a public exchange will not be eligible for QSB certification.

Requirements Concerning Employees

The company must have fewer than 25 employees, measured on a “full-time equivalent” basis (in the same manner as determining the location of employment of the company’s employees). All of the company’s employees, including the company’s officers as well as seasonal and short-term/temporary employees, are counted. If the company is a part of a Unitary Group, all employees of all members of the Unitary Group must be included in this calculation.

All of the company’s employees, other than Interns, must be paid at a rate at least equal to 175 percent of the federal poverty guideline for a family of four. The poverty guideline is published by the Federal Department of Health and Human Services and is generally updated annually. Interns must be paid at a rate at least equal to 175 percent of the federal minimum wage. The federal minimum wage may be modified from time to time. Compliance with these requirements is determined on an employee-by-employee basis, not an average basis.

Once certified as a QSB, a company’s eligibility will not be affected by changes in these guidelines or changes in its rate of pay during the remainder of the year for which certification was granted. The DEED website will be updated from time to time to reflect changes in these guidelines.

For purposes of this calculation, a company may include not only wages and salary paid to the employee but also other non-mandatory benefits deductible by the company and specifically allocable to the employee. For example, contributions to a 401(k) plan and day care expenses may be included.

Payments to an executive officer, board member, or any employee who owns more than 20 percent of the company are exempt from this minimum rate requirement. Payments to family members of such persons are not, however, exempt. This requirement applies not only to the company seeking to be a QSB but also to other entities that are part of a Unitary Group with the applicant. It is an ongoing requirement but failure to comply with it, after certification, will not result in the QSB incurring a tax or other penalty.

There is no requirement of a minimum rate of pay to independent contractors that provide services to the company such as payroll services, computer services, and the like. Companies are cautioned, however, that payments to such services are exempt from this requirement only if the recipients are, in fact, independent contractors. The determination whether a recipient of payments is, in fact, an independent contractor is complicated. The courts, in assessing this issue in cases involving failure to withhold payroll taxes, rely upon numerous factors. Claims that individuals who are paid at an hourly rate less than the guideline will likely be suspect. Entities are urged to seek competent advice from their attorneys or accountants as to this determination.

Please note that certification only qualifies a QSB to receive Qualified Investments. It does not mean that any Angel Credits have been allocated.

CHAPTER 4 QUALIFIED INVESTORS (“ANGELS”)

In order for an investor to be eligible to receive Angel Credits for Qualified Investments, the investor must be certified by DEED as a Qualified Investor. Certification is obtained by submitting an online application to DEED along with a \$350 application fee, which can also be paid online. The link to the online application is available on DEED’s website.

Certification as an Qualified Investor (or Angel) must be obtained prior to making a qualified investment, with one exception: an Angel who is not an accredited investor under the federal securities laws may file an application for certification and pay the required fee before credits are allocated or the non-accredited Angel may elect to make a filing within 30 days after completing the investment.

Within 30 days of receiving an application for certification, DEED must grant certification, reject the application or request additional information. If additional information is requested, the application must be certified or rejected by DEED within 30 days of receiving the additional information. The application fee is not refundable (except that if an application is neither certified nor rejected within 30 days, it is deemed rejected and the fee is to be refunded). Rejected applicants may reapply.

Certification as an Angel is valid for the calendar year in which the certification is obtained. A new certification is required for each subsequent calendar year in which the Angel proposes to make Qualified Investments. Certification as an Angel only qualifies an investor as eligible to make Qualified Investments. It does not mean that any credits have been allocated for his or her investments. The credit allocation process is discussed in Chapter 7, Allocations and Timetable.

In order to be certified as an Angel, an investor must meet several requirements at the time the Qualified Investment is made. These requirements are not ongoing.

Natural Persons

The investor must be a natural person. Corporations, partnerships, limited liability companies and other entities are not eligible to be Angels but may be eligible to be Qualified Funds (if their owners are natural persons). Exception: If a revocable trust makes a Qualified Investment, the investment is treated as if made by the trust beneficiary and the trust need not be certified as a Qualified Fund.

There is no requirement that investors be residents of Minnesota or that they receive taxable income in Minnesota. In order to receive the Angel Credit, however, investors will be required to file a Minnesota tax return for the year of investment even if they would not otherwise be required to do so.

Type of Investment

The investor must certify that he or she will only invest in:

1. a transaction exempt under Minn. Stat. § 80A.46, clause (13) or (14) (in other words, be an accredited investor under SEC rules); or
2. in a security exempt under Minn. Stat. § 80A.461 (the MNvest crowd sourcing exemption); or
3. in a security registered under Minn. Stat. § 80A.50 (b) (Minnesota’s small corporate offering registration).

Ineligible Investors

Although unrelated to the ability to be certified as a Qualified Investor, certain persons are ineligible to receive the credit for investments in QSBs with which they have an “insider” relationship. This includes:

- officers (persons elected or appointed by the board of directors to manage the daily operations of the QSB), and their family members, of the business being invested in, or
- principals (persons having authority to act on behalf of the QSB), and their family members, of the business being invested in, or
- 20 percent or more owners (with family interests combined) of the business being invested in, as well as their family members.

For the latter, ownership includes control or the power to vote 20 percent or more of the outstanding securities of the QSB, with the investor’s individual ownership interest combined with the ownership interests of one or more of the investor’s family members.

Family members include spouses, siblings, lineal descendants, and ancestors.

Required Holding Period

After an investment has been made, the Angel must continue to hold the investment for the remainder of the year of investment and the following two calendar years.

Please note that investor certification only qualifies an Angel to make Qualified Investments. It does not mean that any Angel Credits have been allocated to a particular investment.

CHAPTER 5 QUALIFIED FUNDS

Angel Credits are available for investments in QSBs by Qualified Funds. In order for an entity to be a Qualified Fund and eligible to make investments for which its owners will receive Angel Credits, the entity must be certified by DEED as a Qualified Fund prior to making such investment. Certification is obtained by submitting an online application to DEED, along with a \$1,000 application fee, which can also be paid online. The link to the application form is available on DEED's website. Certification as a Qualified Fund only qualifies the entity as eligible to make Qualified Investments. It does not mean that any credits have been allocated for its investors.

Within 30 days of receiving an application for certification, DEED must grant certification, reject the application or request additional information. If additional information is requested, the application must be certified or rejected by DEED within 30 days of receiving the additional information. The application fee is not refundable (except that if an application is neither certified nor rejected within 30 days, it is deemed rejected and the fee is to be refunded). Rejected applicants may reapply.

Certification as a Qualified Fund is valid for the calendar year in which the certification is obtained. A new certification is required for each subsequent calendar year in which the entity proposes to make Qualified Investments.

Only a Pass-Through Entity is eligible to be a Qualified Fund. When a Qualified Fund makes a Qualified Investment, the credits are not allocated to the fund but, instead, are allocated directly to the Taxpayers who are the equity owners of the fund.

A Qualified Fund must have at least three owners who are natural persons. It may have owners which are not natural persons but they are not eligible for the credit and do not count toward the “three investor” minimum. A Qualified Fund may make a Qualified Investment in a QSB only if the Qualified Fund has at least three owners who would be eligible to receive Angel Credits for their direct investment in the QSB.

Example: Assume that John Q. Taxpayer has been certified as a Qualified Investor. Also assume that John Q. Taxpayer is an equity owner in Great Investments Minnesota LLC which has been certified as a Qualified Fund. If John Q. Taxpayer received more than half of his gross income from Smart Ideas, LLC, he is disqualified from receiving Angel Credits related to investments in Smart Ideas. This is true both as to his direct investments and as to any investments by Great Investments Minnesota. Great Investments Minnesota is eligible to make Qualified Investments in Smart Ideas and credits will be allocated to its owners (other than John Q. Taxpayer). Great Investments’ owners, other than John Q. Taxpayer, may also be allocated Angel Credits for their investments in Smart Ideas other than through Great Investments Minnesota (that is, directly as Angel Investors or indirectly as owners of another Qualified Fund).

Fund members who are considered “insiders” of the QSB in which the fund investment is being made are not eligible for the tax credit. See Chapter 4, Public Solicitation Permitted, for complete details.

The Qualified Fund need not be organized under Minnesota law and owners of the fund need not be Minnesota residents.

After the investment is made, the Fund must continue to hold the investment for the remainder of the year of investment and the following two calendar years.

Please note that certification only qualifies a Qualified Fund to make Qualified Investments. It does not mean that any Angel Credits have been allocated. The credit allocation process is discussed in Chapter 7, Allocations and Timetable.

CHAPTER 6 QUALIFIED INVESTMENTS

In addition to the Angel, Qualified Fund and QSB certification requirements previously discussed, the investment must be a Qualified Investment. Certain requirements must be met in order for an investment to be treated as a Qualified Investment. These requirements relate to the nature of the security received by the investor, the nature of consideration given by the investor, the minimum size of the investment, the maximum credits that can be allocated for investments in each QSB, the maximum credits that may be claimed by each Taxpayer, and the required status under Minnesota securities laws of issuances of securities eligible for the credit.

Restrictions on “Insiders”

Even though certified as an Angel, an investor may not be eligible for credits in connection with certain investments. An Angel (or fund member) may not be allocated credits for a proposed investment if the Angel is an “insider” of the QSB. “Insiders” include:

- officers (persons elected or appointed by the board of directors to manage the daily operations of the QSB), and their family members, of the business being invested in, or
- principals (persons having authority to act on behalf of the QSB), and their family members, of the business being invested in, or

- 20 percent or more owners (with family interests combined) of the business being invested in, as well as their family members.

For the latter, ownership includes control or the power to vote 20 percent or more of the outstanding securities of the QSB, with the investor's individual ownership interest combined with the ownership interests of one or more of the investor's family members. Note that this list does not include directors of the QSB, though directors may fall into one of the other categories and thus be ineligible for the credit.

Family members include spouses, siblings, lineal descendants, and ancestors.

Equity Investment Requirements

Only equity investments in QSB are eligible for the credit. Eligible forms of equity include common stock, preferred stock, interests in general partnerships, interests in limited partnerships, membership interests in limited liability companies and membership interests in limited liability partnerships. Status as an eligible form of investment is not affected by whether the QSB is a Pass-Through Entity.

Many companies have more than one classes of preferred equity. Preferences can include differences in voting rights, dividends, liquidation, appointment of directors or managers, approval of certain transactions, among others. So long as the securities being issued are equity securities, class preferences and differences will not affect eligibility for the credit.

Treatment of Certain Convertible Debt Investments as Equity

Some promissory notes and other debt provide that they are, or will become, convertible into equity. If the terms and conditions of such conversion meet certain requirements, these promissory notes and debt investment may be treated as equity investments. In order to be a Qualified Investment, such promissory note or debt investment must be subject to mandatory conversion into equity within the three year annual reporting period of the investor, without any further action or consent by the Angel. The mandatory conversion must not be subject to any conditions. For example, a promissory note that provides that it will automatically and mandatorily convert into common stock on December 31 of the third year of its issuance will be eligible for the credit [example: a note issued any time in 2019 must convert by 12/31/2021]. Some promissory notes and other debt are convertible into equity, but the conversion is solely at the election of the holder. Because there is no obligation to convert, these debt investments will not be eligible for the credit.

Some promissory notes and other debt are not immediately convertible but become subject to conversion (either mandatory or at the election of the Angel) only upon satisfaction of defined contingencies. Typical contingencies are receipt by the QSB of a minimum amount of funding, achievement by the QSB of financial or operational goals, and similar conditions. Because there is no unconditional obligation to convert, these debt investments will not be eligible for the credit. This is true even if the obligation to convert may become mandatory.

If a promissory note or other debt contains both a mandatory conversion provision and an optional right to convert earlier than the automatic conversion date (where the optional rights may be immediate, deferred or contingent), the debt investment will be treated as equity – so long as the mandatory conversion, by its terms, must occur within the three year annual reporting period of the investor.

Important Note: In 2013, statutory amendments to the program added additional complications for those seeking to structure convertible debt investments as Qualified Investments. Under the amendments, an investment cannot be treated as a Qualified Investment if a Liquidation Event occurs with respect to the investment within 180 days after its issuance date. The new definition of a Liquidation Event includes any “conversion of qualified investment for cash, cash and other consideration, or *any other form of equity* or debt interest.” The conversion of a qualified, convertible debt investment into equity in the company is not excluded. As a result, conversion of an otherwise qualified debt instrument into the company’s equity within 180 days of the investment date, for any reason, will trigger the Liquidation Event prohibition and disqualify an otherwise qualified mandatorily convertible debt instrument from being treated as a Qualified Investment.

Comment: Businesses that seek to have convertible debt treated as equity under the program are strongly encouraged to submit their proposed forms of convertible debt instruments for review by to DEED before finalizing terms of those investments.

In addition to the types of securities specifically identified, DEED is authorized to consider other forms of investment and, if appropriate, treat them as eligible.

Cash Consideration Requirements

The Angel's or Qualified Fund's investment in a QSB must be a cash investment. Services rendered to the QSB do not qualify nor do assignments of assets, whether tangible (such as real estate and equipment) or intangible (such as patents).

If promissory notes (or other debt) of the QSB are converted into equity of the QSB, such conversion does not qualify. This limitation applies both where the debt holder has a right to convert the note into equity and where the conversion into equity is negotiated at the time of conversion. (Note: Cash paid to a QSB to purchase equity is an eligible form of consideration without regard to the source of the cash. If a QSB repays a note owed to an Angel and the Angel immediately uses that cash to purchase equity securities in the QSB, this requirement will be satisfied.)

Minimum Investment Requirements

In order for an investment to be treated as a Qualified Investment, the amount invested must be above a stated minimum.

Angels - \$10,000 Minimum Investment

The minimum investment requirement for Angels is \$10,000 per QSB investment, except for QSBs that are qualified greater Minnesota businesses or that are women, minority, or veteran-owned, in which case the minimum investment is \$7,500. This requirement applies to *an* investment in *each* QSB. Separate investments by an Angel of \$5,000 in two separate QSBs will not be a Qualified Investment, but a subsequent investment in the same QSB of less than \$10,000 within the same year will qualify.

Qualified Funds - \$30,000 Minimum Investment

The minimum investment requirement for Qualified Funds is \$30,000 per QSB investment. Note that Qualified Funds are not required to receive a minimum level of funding from each of their owners. This means that an equity owner of a Qualified Fund is eligible to receive his or her proportionate share of credits generated by investments by the fund even if the Taxpayer's underlying investment in the Qualified Fund is less than \$10,000.

Maximum Qualified Investments and Angel Credits

The total amount of Qualified Investments in each QSB may not exceed \$4 million. This equates to \$1 million of Angel Credits. This limitation is a lifetime maximum and there is no annual maximum limitation.

Caution: Depending upon the timing of Qualified Investments and other investments, a company that is eligible to be a QSB in one year may become ineligible to be a QSB in a later year based upon issuances of equity (both eligible and ineligible for the credit).

The maximum Angel Credits a Taxpayer may receive in any calendar year is \$125,000 which relates to Qualified Investments of \$500,000. The maximum amount of Qualified Investments for each Taxpayer includes investments directly by the Taxpayer and the Taxpayer's proportionate share of investments through a Qualified Fund for which the Taxpayer is allocated credits.

Taxpayers who are married and file a joint return may receive up to \$250,000 of credits each year which relates to Qualified Investments of \$1 million. This is without regard to who made the investments.

The following examples illustrate this limitation. If a husband and wife separately make Qualified Investments of \$500,000, each is entitled to \$125,000 of credits which may be claimed without regard to whether they file a joint tax return or separate tax returns. If, instead, one spouse makes Qualified Investments of \$1 million, the maximum credit available will depend upon their filing status. If they file a joint return, they can receive \$250,000 of credits. If they file separate returns, the spouse making the investment will receive \$125,000 of credits and the non-investing spouse will not receive any credits.

Securities Law Status of Qualified Investments

The Minnesota Securities Act requires that all offers and sales of securities must be registered unless such offers and sales are made pursuant to valid exemptions from registration. This requirement is in addition to federal securities registration requirements. The Angel Credit is available only if the securities issued to the Angel and/or to the Qualified Fund are offered and sold pursuant to two specified exemptions from registration or pursuant to a short-form registration. Each is discussed in turn.

The Minnesota Securities Act provides an exemption for sales of securities to “accredited investors,” “institutional investors,” and certain other persons. The term “accredited investor” is defined under the federal Securities Act of 1933, as amended. Although there are several other categories, the most commonly relied-upon categories are natural persons who have a net worth of \$1 million or more (not including their principal residence), individuals with a \$200,000 net income for the past two years and reasonably expected in the current year, married couples with joint net income of \$300,000 in each of the last two years and reasonably expected in the current year, and directors, executive officers (as defined)

and general partners of the company. (Note: The number of persons who qualify as accredited investors was significantly reduced by Congress in the Dodd-Frank Wall Street Reform Act which was enacted in July 2010. Investors previously could include the value of their principal residence in determining net worth but now may not include such value.)

The Minnesota Securities Act also provides an exemption from registration for sales of securities made as part of a “private placement.” This exemption limits the number of investors, prohibits general solicitation, limits commissions, sometimes requires a filing to be made, and is subject to other conditions.

The Minnesota Securities Act provides for a “mini public offering” registered as a Small Corporate Offering Registration (“SCOR”). SCOR does not limit the number of investors and public solicitation of investors is permitted. An issuer may sell up to \$1 million of its securities, subject to certain reductions. Issuers are required to file a “short-form” registration statement which is subject to minimal review, to provide each investor with a simplified offering document and to meet certain other conditions and requirements. SCOR is not available to certain types of issuers nor to issuers engaged in certain types of business. SCOR is subject to “bad boy” provisions identical to those of the Angel Credit.

CHAPTER 7 ALLOCATIONS AND TIMETABLE

After required certifications have been obtained (with one exception), the QSB together with an Angel and/or a Qualified Fund may jointly submit a tax credit request application to DEED requesting allocation of Angel Credits. (Exception: An Angel who is not an accredited investor under the federal securities laws may choose to file his or her application for certification and pay the required fee within 30 days after completing his or her investment.) The form of such request is available on DEED's website. The request for allocation will identify and provide information regarding Angels (both certified and uncertified) and/or Qualified Funds, the QSB, prior issuances of the QSB's equity for which Angel Credits have been allocated and information about the proposed investment transaction.

The request for allocation needs to identify each Taxpayer to whom credits will be issued, both directly as an Angel and as an equity owner of a Qualified Fund, and information about the Taxpayer's prior credits and the related transactions. No fee is required in connection with filing a request for allocation.

DEED will review the request for completeness, eligibility, and compliance with the limitations as to the maximum allocation of Angel Credits, both as to the QSB and each Taxpayer. Requests must be approved or rejected by DEED within 15 days of receipt. Credits will be allocated in the order that the applications are filed

with DEED. The dates that required certifications are obtained is irrelevant in determining the amount of credits to be allocated except that applications for allocation of Angel Credits are not deemed filed until all required certifications have been obtained.

All requests for allocation filed on the same day are treated as having been filed simultaneously. If two or more requests are filed on the same day and fewer credits are available than requested, the available credits will be allocated pro-rata among the requests filed on that day.

Once credits have been allocated, the Qualified Investment must be made within 60 days of the date of allocation. The investment must also be made prior to December 31st. If these time limitations are not satisfied, the allocation will be canceled and the credits will become available for reallocation for other investments. If, however, all credits have been allocated for the year and the program is closed, those unused credits will be rolled forward to the next year.

Angels, Qualified Funds and QSBs can make multiple requests for allocation during each year. Each is reviewed separately as to completeness and each allocation of credits is made based upon the date the request was filed. The determinations of Angel, Qualified Fund and QSB eligibility are made only at the time of the application for certification and are not reconsidered upon submission of a request for allocation of credits.

CHAPTER 8 REPORTING

After an investment has been completed, Angels and Qualified Funds must notify DEED of the closing of the investment. An Angel or Qualified Fund that fails to complete the proposed investment must notify DEED within five business days of the expiration of the 60-day investment period. There is no provision for extension of these time periods.

At the end of each year, DEED will issue a tax credit certificate to each Taxpayer for the total amount of credits allocated to the Taxpayer. The Taxpayer will receive one certificate relating to all Qualified Investments including those made directly by the Taxpayer as an Angel, those made by a Qualified Fund of which the Taxpayer is an owner, and those made by a revocable trust of which the Taxpayer is the beneficiary. Certificates will not be issued to Qualified Funds.

By February 1st of each year, each QSB that received a credit-generating investment and each Angel and each Qualified Fund that made a credit-generating investment during the year must submit an annual report to DEED and pay a \$100 filing fee. Failure to file a timely report will result in a fine of \$100 in addition to the \$100 filing fee. Failure to file an annual report by April 1 by an Angel or Qualified Fund can cause an allocated credit to be revoked, requiring repayment by the investor, and failure to file by a QSB can require that the business pay a tax in the amount of a proportion of the credits awarded to its investors (See Chapter 9, Tax on the Qualified Small Business).

Angels and Qualified Funds must submit a report for the year in which they made a Qualified Investment for which credits were issued and for the following two years. The report must certify that the investor (i.e. an Angel or a Qualified Fund) remains invested in the QSB.

QSBs must submit a report for each year in which they received investments for which credits were issued and for five years thereafter. The reports must certify that the QSB continues to satisfy the following requirements:

- The QSB has its headquarters in Minnesota;
- At least 51 percent of the QSB's employees are employed in Minnesota;
- At least 51 percent of the QSB's total payroll is paid or incurred in Minnesota; and
- The QSB continues to be engaged in, or remains committed to engage in, innovation in Minnesota as required under the conditions of certification.

A company that ceases all operations and becomes insolvent must file an insolvency report documenting its insolvency. Investors of such companies, when filing their investor annual report, should indicate that their investment has become worthless; this will relieve Taxpayers of their obligation to file subsequent annual reports related to that investment.

CHAPTER 9 POST-INVESTMENT REQUIREMENTS: REVOCATION AND REPAYMENT

Revocation and Repayment by the Taxpayer

The Angel Credit is subject to revocation if the Angel or Qualified Fund fails to hold the securities until after the end of the second calendar year after their investment. For example, securities acquired on any date in 2019 must be held until at least January 1, 2022.

If the Angel or Qualified Fund fails to hold the securities for the requisite period of time and no exemption is available, the credits are revoked and must be repaid. The amount required to be repaid is not affected by the period between the investment and the date of revocation. If the credits are revoked for failure to hold for the required period, the Taxpayer must file an amended Minnesota tax return for the year of investment and must repay the entire amount of credits received, both within 30 days of the date of revocation. If the securities were purchased by a Qualified Fund, the fund must notify its members of the revocation. Such members must file amended tax returns and repay the credit. The fund is not required to file a return or pay any tax or penalty.

Under certain circumstances, revocation is not appropriate. The revocation does not apply in any of the following circumstances:

- The securities become worthless;
- The QSB sells 80 percent or more of its assets;
- The QSB is sold;
- The QSB's common stock begins trading on a public exchange;
or
- The death of the Taxpayer

Tax on the Qualified Small Business

A QSB that receives Qualified Investments that result in the issuance of Angel Credits to Taxpayers must continue to employ at least 51 percent of its employees in Minnesota. The QSB must also continue to pay or incur at least 51 percent of its total payroll in Minnesota. These requirements must be met in the calendar year the Qualified Investment was received and for five years thereafter.

If the employee and payroll requirements are not met, the QSB must pay a tax equal to a percentage of the Angel Credits:

<u>Year after investment</u>	<u>Percentage</u>
Year of investment and first year after investment	100%
Second	80%
Third	60%
Fourth	40%
Fifth	20%
Sixth or later	0%

In addition to the employee and payroll requirements, QSBs are required to meet other requirements. They must continue to be engaged in or committed to engage in innovation in Minnesota with their primary business activities within one of the permissible categories. Additionally, they must maintain their headquarters in Minnesota, continue to engage in innovation, and continue to comply with the minimum rate of pay requirements. Failure to comply with these additional requirements, however, does *not* result in loss of the credit or require the QSB to pay any tax.

Even if the QSB fails to comply with its ongoing requirements, the Angel Credit received by the Taxpayer is not subject to revocation or repayment.

APPENDIX A DISQUALIFICATION PROVISIONS

Disqualification Provisions

[Minn. Stat. § 80A.50 sec. 302(b)(3)]

(3) **Disqualification.** Registration under this section is not available to any of the following issuers:

- (A) an issuer subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934;
- (B) an investment company;
- (C) a development stage company that either has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies or other entity or person;
- (D) an issuer if the issuer or any of its predecessors, officers, directors, governors, partners, ten percent stock or equity holders, promoters, or any selling agents of the securities to be offered, or any officer, director, governor, or partner of the selling agent:

- (i) has filed a registration statement that is the subject of a currently effective registration stop order entered under a federal or state securities law within five years before the filing of the small corporate offering registration application;
- (ii) has been convicted within five years before the filing of the small corporate offering registration application of a felony or misdemeanor in connection with the offer, purchase, or sale of a security or a felony involving fraud or deceit, including, but not limited to, forgery, embezzlement, obtaining money under false pretenses, larceny, or conspiracy to defraud;
- (iii) is currently subject to a state administrative enforcement order or judgment entered by a state securities administrator or the Securities and Exchange Commission within five years before the filing of the small corporate offering registration application, or is subject to a federal or state administrative enforcement order or judgment in which fraud or deceit, including, but not limited to, making untrue statements of material facts or omitting to state material facts, was found and the order or judgment was entered within five years before the filing of the small corporate offering registration application;
- (iv) is currently subject to an order, judgment, or decree of a court of competent jurisdiction temporarily restraining or enjoining, or is subject to an order, judgment, or decree of a court of competent

jurisdiction permanently restraining or enjoining the party from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving the making of a false filing with a state or with the Securities and Exchange Commission entered within five years before the filing of the small corporate offering registration application; or

(v) is subject to a state's administrative enforcement order, or judgment that prohibits, denies, or revokes the use of an exemption for registration in connection with the offer, purchase, or sale of securities,

(I) except that clauses (i) to (iv) do not apply if the person subject to the disqualification is duly licensed or registered to conduct securities-related business in the state in which the administrative order or judgment was entered against the person or if the dealer employing the party is licensed or registered in this state and the form BD filed in this state discloses the order, conviction, judgment, or decree relating to the person, and

(II) except that the disqualification under this subdivision is automatically waived if the state securities administrator or federal agency that created the basis for disqualification determines upon a showing of good cause that it is not necessary under the circumstances to deny the registration.

