

Massachusetts Enacts Angel Investor Tax Credit

Massachusetts Governor Charlie Baker, on August 10, 2016, signed an economic development bill into law which includes an angel investor tax credit. This angel investor tax credit will be available for tax years beginning on or after January 1, 2017. This credit could spur a significant amount of investment in certain qualifying Massachusetts businesses, including start-ups.

The Tax Credit Generally

Certain investors are eligible for the Massachusetts angel investor tax credit if they make a “qualifying investment” in a “qualifying business.” The amount of the Massachusetts tax credit equals 20% of the amount of the “qualifying investment” or 30% if the “qualifying business” has its principal place of business located in certain municipalities. These investors may invest up to \$125,000 per “qualifying business” per year with a \$250,000 maximum for each “qualifying business.” The total of all tax credits available to an investor cannot exceed \$50,000 in a single calendar year.

This credit may be taken against Massachusetts income tax due in either the tax year of the initial investment or in any of the three subsequent taxable years. Any amount of the tax credit that exceeds the Massachusetts tax due for a taxable year may be carried forward by the investor to any of the three subsequent taxable years.

What Type of Business Qualifies?

A “qualifying business” for purposes of this credit is a business which (i) has its principal place of business in Massachusetts, (ii) has at least 50% of its employees located in the business’s principal place of business; (iii) has a fully developed business plan that includes all appropriate long-term and short-term forecasts and contingencies of business operations, including research and development, profit, loss and cash flow projections and details of angel investor funding; (iv) employs 20 or fewer full-time employees at the time of the investor’s initial qualifying investment; (v) has a federal tax identification number, and (vi) has gross revenues equal to or less than \$500,000 in the fiscal year prior to eligibility.

An investment in a business involved in retail, real estate, professional services, gaming or financial services does not qualify for the angel investor tax credit. The credit appears to be directed at creating and maintaining jobs in the digital e-health, information technology and healthcare sectors. The legislation, however, does not appear to limit the credit to these specific sectors. Regulations must be promulgated to carry out the goal of creating and maintaining jobs and we would expect these regulations to clarify what type of businesses qualify for the credit.

Who Can Claim the Credit?

Only an investor who is an accredited investor and who is not the principal owner of the “qualifying business” and who is involved in the “qualifying business” as a full-time professional activity is eligible to claim the credit. Further, venture capital funds, hedge funds or commodity funds with institutional investors are not eligible for this credit. Hopefully regulations will clarify the ambiguity related to the requirement that an investor must be involved in the “qualifying business” as a full-time professional activity. Regulations could hinder the effectiveness of this credit if the regulations are overly restrictive as to this requirement.

What Type of Investments Qualify?

A “qualifying investment” is a monetary investment that is at risk and is not secured or guaranteed. We interpret this to mean an equity financing as opposed to debt financing. This legislation also provides that a “qualifying investment” may only be used by a “qualifying business” for capital improvements, plant equipment,

research and development, and working capital. This legislation goes on further to state that “qualifying investment” cannot be used to pay dividends, fund or repay shareholders’ loans, redeem shares, repay debt or pay wages or other benefits of the investor.

These limitations on the use of “qualifying investment” proceeds will be difficult to apply in practice since money is fungible. It will be interesting to see how the regulations address this issue, if at all.

Boom or Bust?

This angel investor tax credit appears to be a promising provision which could spur economic growth and job creation in Massachusetts. How effective this credit will become depends largely on the regulations to be promulgated. These regulations could just as easily limit the availability of this credit or expand the credits availability to a diverse group of businesses. Once the regulations have been issued, we will send another client advisory describing eligibility for the credit.

This advisory is for information purposes only, and does not constitute legal advice. If you would like to discuss the Massachusetts angel investor tax credit, please contact Jeff Groshek or David Moran at (617) 350-6800 or email us at jeff.groshek@gesmer.com or david.moran@gesmer.com.



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