Guidelines Regarding Crowdfunding Investments that Qualify for Tax Credits

Introduction

During the 2013 Session, the Virginia General Assembly enacted House Bill 1872 (2013 *Acts of Assembly*, Chapter 289), which clarifies that a crowdfunding investment is eligible for any income tax credit for which it otherwise qualifies. This legislation required the Department of Taxation ("the Department") to develop guidelines to facilitate the submission of any electronic documents by a taxpayer to document or verify that an eligible crowdfunding investment has been made.

These guidelines are published by the Department to provide guidance to taxpayers regarding tax credits that crowdfunding investments may be used to claim. These guidelines are not rules or regulations subject to the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 et seq.) and are being published in accordance with the Tax Commissioner's general authority to supervise the administration of the tax laws of the Commonwealth pursuant to *Va. Code* § 58.1-202. As necessary, additional information will be published and posted on the Department's website, www.tax.virginia.gov.

These guidelines represent the Department's interpretation of the relevant laws. They do not constitute formal rulemaking and hence do not have the force and effect of law or regulation. In the event that the final determination of any court holds that any provision of these guidelines is contrary to law, taxpayers who follow these guidelines will be treated as relying on erroneous written advice for purposes of waiving penalty and interest under *Va. Code* §§ 58.1-105, 58.1-1835, and 58.1-1845. To the extent there is a question regarding the application of these guidelines, taxpayers are encouraged to write to the Department and seek a written response to their question.

Background

Crowdfunding is a term used to describe the practice of financing projects by raising monetary contributions from a large number of people. The concept of crowdfunding has been around for centuries and has been used to help finance a variety of ventures including, but not limited to, artistic and charitable endeavors. Since the 1990's, crowdfunding has been increasingly transacted through the internet. Although crowdfunding has historically been used for a variety of purposes, the federal securities laws have generally prohibited companies from selling equity through crowdfunding.

In 2012, Congress enacted the Jumpstart Our Business Startups ("JOBS") Act, which created an exemption to federal securities laws that permits certain businesses to engage in equity crowdfunding transactions over the internet. The JOBS Act imposes restrictions on such equity crowdfunding transactions including, but not limited to:

- Permitting equity crowdfunding transactions to only be conducted through an intermediary that is either registered as a broker-dealer or that is registered as a new type of internet-based entity known as a funding portal.

- Limiting the amount of funds a business may raise under the crowdfunding exemption during a twelve-month period to $1 million.

- Limiting the aggregate amount of investments an individual may make in equity crowdfunding issuers during a twelve-month period to:
    - The greater of $2,000 or 5 percent of annual income or net worth, if the annual income or net worth of the investor is less than $100,000; or
    - 10 percent of annual income or net worth (not to exceed an amount sold of $100,000), if the annual income or net worth of the investor is equal to or greater than $100,000.

Despite the passage of the JOBS Act, selling equity through crowdfunding generally remained impermissible until the Securities and Exchange Commission ("SEC") published its final rules regarding such transactions. On October 30, 2015, the SEC released rules that widely permit certain businesses to sell equity through crowdfunding. These rules became effective on May 16, 2016.

Authorized Crowdfunding Investments

2013 House Bill 1872 required the Department to develop guidelines to facilitate the submission of any electronic documents by a taxpayer to document or verify that an eligible crowdfunding investment has been made. These guidelines apply to any crowdfunding investment that is authorized by the SEC through its regulations and transacted via an online general solicitation, an online broker, or a funding portal. For purposes of these guidelines, "funding portal" means a website that:

- Allows accredited investors to participate in general solicitation transactions by an issuer that meet the requirements of § 4(a)(6) of the Securities Act of 1933, P.L. 112-106; or
- Is an online broker or funding portal registered with the SEC pursuant to § 4A(a) of the Securities Act of 1993, P.L. 112-106.

If the SEC promulgates additional regulations or if Congress enacts legislation in the future that permit additional types of crowdfunding investments that are not currently authorized, these guidelines will also apply to such investments to the extent they are transacted via an online general solicitation, an online broker, or a funding portal.

Tax Credits that May Be Claimed Based on a Crowdfunding Investment

Currently, the Qualified Equity and Subordinated Debt Investments Tax Credit is the only Virginia tax credit that is directly based upon an equity investment made by the taxpayer. Accordingly, this is the only Virginia tax credit currently impacted by these guidelines. If the Virginia General Assembly later enacts a new tax credit or amends an existing tax credit such that equity investments would qualify, the Department will update these guidelines to explain the application of such tax credit(s) to crowdfunding investments.

Overview of the Qualified Equity and Subordinated Debt Investments Tax Credit

The Qualified Equity and Subordinated Debt Investments Tax Credit is an individual and fiduciary income tax credit equal to 50 percent of a taxpayer's qualified investments. A "qualified investment" means a cash investment in a qualified business in the form of equity or subordinated debt, subject to certain exceptions. A "qualified business" means a business that:

- Has annual gross revenues of no more than $3 million in its most recent fiscal year;
- Has its principal office or facility in the Commonwealth;
- Is engaged in business primarily in or does substantially all of its production in the Commonwealth;
- Has not obtained during its existence more than $3 million in aggregate gross cash proceeds from the issuance of its equity or debt investments (not including commercial loans from chartered banking or savings and loan institutions); and
- Is primarily engaged, or is primarily organized to engage, in the fields of advanced computing, advanced materials, advanced manufacturing, agricultural technologies, biotechnology, electronic device technology, energy, environmental technology, information technology, medical device technology, nanotechnology, or any similar technology-related field as provided in regulations promulgated by the Department.

An investment in a qualified business may only qualify for the credit if such business applies for and receives a qualified business certification from the Department for the calendar year in which such investment was made. To apply for a qualified business certification, a business must submit a completed Form QBA to the Department on or before December 31 of the calendar year for which it wishes to be certified. A qualified business must submit a new Form QBA and receive a new qualified business certification for each year that it wants investments in such business to qualify for the credit.

The aggregate amount of the tax credit for each taxpayer may not exceed the lesser of the amount of tax imposed on them for such taxable year or $50,000. Any tax credit that is not usable in the taxable year in which the tax credit was first allowed, may be carried over for the next fifteen succeeding taxable years or until the total amount of the tax credit has been taken, whichever occurs first.

The total amount of tax credits is capped at $5 million for Taxable Year 2014 and thereafter. One-half of the amount of available tax credits must be allocated exclusively for tax credits for commercialization investments. However, if the amount of tax credits requested for commercialization investments is less than one-half of the total amount of available tax credits, then the balance of such tax credits must be allocated for non-commercialization investments.

If a taxpayer fails to hold equity received in connection with a qualified investment for at least three full calendar years following the calendar year for which a tax credit for a qualified investment is allocated, then the taxpayer will be required to forfeit both the used and unused tax credits and to pay the Department interest on the total allowed tax credits from the date the tax credits were allocated to the taxpayer. Exceptions include transfers of such equity that were the result of (i) the liquidation of the qualified business issuing such equity, (ii) the merger, consolidation, or other acquisition of such business with or by a party not affiliated with such business, or (iii) the death of the taxpayer.

A crowdfunding investment made by a taxpayer via an online general solicitation, an online broker, or a funding portal, may qualify for the Qualified Equity and Subordinated Debt Investments Tax Credit to the extent that such investment meets the definition of a "qualified investment" pursuant to *Va. Code* § 58.1-339.4. For additional information regarding the Qualified Equity and Subordinated Debt Investments Tax Credit, see *Va. Code* § 58.1-339.4.

<u>Submission of Required Documents</u>

A taxpayer applying for the Qualified Equity and Subordinated Debt Investments Tax Credit is required to submit a completed Form EDC to the Department by April 1 of the year an investment qualifying for the credit was made, along with the following documents:

- A copy of the qualified business certification (issued to the business by the Department after the business submits a completed Form QBA to the Department); and

- A business entity's statement, on the business' letterhead, containing:

    - The investor's name;

    - The investment by amount (list each amount separately);

    - The investment by type (equity or debt);

    - The investment by date (specific to each investment amount); and

    - Verification that the investment meets the definition of a "qualified investment" for purposes of claiming the Qualified Equity and Subordinated Debt Investments Tax Credit.

You may submit Form EDC and the above required documentation to the Department electronically. For information regarding how to submit Form EDC and any required documentation electronically, please contact the Department's Tax Credit Unit at (804) 786-2992. Applications and supporting documentation may also be faxed or mailed to the Department. For more information regarding Form EDC and the required documents, see the Form EDC instructions on the Department's website at www.tax.virginia.gov.

Approved:

Craig M. Burns
Tax Commissioner