

ARKANSAS REGISTER

Proposed Rule Cover Sheet



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Name of Department _____

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Equity Investment Incentive Act of 2007

(Act 566 of 2007, as amended)

Rules

I. Introduction

Act 566 of 2007, also known as the “Equity Investment Incentive Act of 2007,” as amended and codified at § 15-4-3301 et seq., provides a tax credit for equity investments in targeted, early-stage, and start-up businesses. The purpose of equity investment incentives is to encourage capital investment in certain types of early-stage businesses that are creating new, higher-paying jobs for the State of Arkansas.

II. Definitions

1. “Commission” means the Arkansas Economic Development Commission;
2. “Convertible financing structure” means an investment mechanism that converts into equity at a subsequent event, including without limitation convertible debt, convertible equity, and a convertible note;
3. “Director” means the Executive Director of the Arkansas Economic Development Commission;
4. “Eligible business” means a business that has been approved and has a signed equity investment incentive agreement with the Commission to participate and solicit equity investments in the business;
5. “Investor” means a person or entity purchasing an equity investment in an eligible business or otherwise advancing funds to the business under the terms of a qualifying convertible financing structure if the convertible financing structure is required to be converted to equity by the business receiving the investment no later than five (5) years from the date the convertible financing structure was consummated.

III. Eligibility

Eligibility for the equity investment incentive tax credit under this subchapter is limited to investments in:

1. Targeted businesses as defined in § 15-4-2703(43); or
2. A business that receives assistance in the form of equity investments from capital investment funds that target early-stage businesses and start-up businesses, if the business:
 - A. Pays at least one hundred fifty percent (150%) of the lesser of the

county average wage or the state average wage; and

B. Meets at least two (2) of the following conditions:

- (i) The business is in one (1) of the business sectors set forth in § 15-4-2703(43)(A)(i)-(vi);
- (ii) The business is identified in a local or regional economic development plan as the type of business targeted for recruitment or growth within the community or region;
- (iii) The business is supported by a resolution of the city council or quorum court in the municipality or county in which the business is located or plans to locate;
- (iv) The business is supported by business incubators certified under § 26-51-815(d);
- (v) The business is supported by federal small business innovation research grants; or
- (vi) The business is supported by technology development or seed capital investments made by instrumentalities of the state.

IV. Approval

A business that seeks eligibility for an equity investment incentive tax credit under this subchapter shall file an application with the Arkansas Economic Development Commission. The application shall include:

- 1. A business plan describing the proposed business for which an equity investment incentive tax credit is sought;
- 2. A projection of the amount of capital being sought for the proposed business;
- 3. If the application proposes to use a convertible financing structure, a clear statement concerning the timing and conditions under which the convertible financing structure converts into equity; and
- 4. Other information requested jointly by the Executive Director of the Arkansas Economic Development Commission and the President of the Arkansas Development Finance Authority.

The Commission shall gather information necessary to determine the eligibility of a business that seeks an equity investment incentive tax credit and process the application.

The Commission shall share the application and all information concerning the business with the Arkansas Development Finance Authority and the Division of Science and Technology of the Arkansas Economic Development Commission for review and concurrence on whether or not an equity investment incentive is offered to the business.

The award of the equity investment incentive tax credit to a qualified business under this subchapter shall be determined jointly at the discretion of the Executive Director of the Arkansas Economic Development Commission with the advice of the Board of Directors of the Division of Science and Technology of the Arkansas Economic Development Commission and the President of the Arkansas Development Finance Authority.

Upon approval of the application, the approved business shall sign an equity investment incentive agreement with the Commission.

V. Equity Investment Tax Credits

After the equity investment incentive agreement has been signed by the business and the Commission, the business may solicit investors and offer the equity investment incentive tax credit to the investors. Only cash investments shall qualify for the equity investment incentive tax credit under this subchapter, including without limitation the initial principle amount of a qualifying convertible financing structure if the convertible financing structure is required to be converted to equity by the business receiving the investment no later than five (5) years from the date the convertible financing structure was consummated.

For the equity investment tax credit to be awarded to an investor, the eligible business shall verify that all conditions to the award of an equity investment incentive tax credit stated in the equity investment incentive agreement have been met within the time set forth in the agreement.

A purchaser of an equity interest in an eligible business is entitled to a credit against any state income tax liability that may be imposed on the purchaser for any tax year beginning in the tax year in which the equity interest was purchased and for a period not to exceed nine (9) years beyond the tax year in which the equity interest was purchased.

The equity investment must be made in the calendar years 2007 through 2028.

The equity investment tax credit incentive shall be equal to thirty-three and one-third percent (33 1/3%) of the approved amount invested by an investor in an eligible business.

In any one (1) tax year, the credit allowed shall not exceed fifty percent (50%) of the net Arkansas state income tax liability or premium tax liability of the taxpayer: (a) after all other credits and reductions in tax have been calculated; and (b) before the credit allowed by this section is applied.

Any unused credit may be carried forward and applied against Arkansas state income tax for the next-succeeding tax year and annually thereafter for a total period of nine (9) years succeeding the year in which the equity interest in a business was purchased or until the credit is exhausted, whichever occurs first.

VI. Issuance of Tax Credit

Upon receipt of the qualified investment, whether through the sale of an equity interest, or the issuance of a convertible debt instrument by the company in exchange for an infusion of cash from the investor, the qualified business shall provide the following documentation to the Arkansas Economic Development Commission:

1. The name and address of the original purchaser(s);
2. The tax identification number(s) of the person(s) entitled to the credit;
3. The original date of the qualified transaction;
4. The number and type of equity investment purchased;
5. The amount paid by the original purchaser for the equity interest or convertible debt instrument;
6. The amount of dividends and distributions previously paid by the business to the purchaser;
7. Articles of Incorporation;
8. Certificate of Good Standing;
9. Subscription Agreement for equity purchase or a Purchase Agreement detailing a convertible debt structure, terms, and conversion event; and
10. Proof of transfer of funds documenting the investor as the source of funds and the company as the recipient.

The Arkansas Economic Development Commission will issue a certificate of tax credit that must be attached to the income tax return on which the credit is first claimed.

Issuance of credit to a pass-through entity shall be according to each member's proportional ownership interest of the pass through entity.

VII. Sale or Transfer of Credit

The income tax credits earned under this program may be sold upon approval by the Commission. Any sale of tax credits through this program must be fully documented by the Commission and that information will be transmitted to the Department of Finance and Administration.

The purchaser of the tax credits provided by this program shall obtain certification from the Commission and attach the appropriate documentation provided by the Commission to the tax return on which the credit is first claimed.

The tax credit ~~must~~ may be sold at any time before the tax credit is exhausted or expires within one year of its being issued by the Commission. The original investor earning tax credits under this section may sell its tax credits only one (1) time, in whole or in part, the balance of which shall be used by the original investor within the time frame allowed under this subchapter.

The purchaser of the tax credit shall be subject to the same carry forward provisions of the credits as the original owner of the credits.

VIII. Sale or Disposition of Equity Interest

For the purpose of ascertaining the gain or loss from the sale or other disposition of an equity interest in a business, the owner of the equity interest shall reduce his or her basis in the equity interest by the amount of cash received from selling the tax credits and the tax credits previously deducted under this section. However, sale or other disposition does not include a transfer from the holder of an equity interest to the business in liquidation of the equity interest. This reduced basis shall be used by the original purchaser or transferee when calculating tax due under the Income Tax Act of 1929, § 26-51-101 et seq.

IX. Limitations

The total cumulative amount of tax credits available to all purchasers of equity interest in qualified businesses under these rules and regulations and under § 15-4-1026 in any calendar year shall not exceed six million two hundred and fifty thousand dollars (\$6,250,000).

If the total amount of credits applied for under this subchapter for the year exceeds the cap, the AEDC, when allocating credits under this subchapter for the particular applications that would exceed that cap and in order not to exceed the cap, shall first award credits to investors taking an equity interest through an equity purchase before credits may be allocated to investors that use a convertible financing structure for the investment.

X. Coordination with the Arkansas Capital Development Company Act

All agreements and commitments of the capital development company related to the purchase of equity interests in existence before July 1, 2007, and certified to the Commission shall remain valid and enforceable, shall be entitled to the tax credits set forth in Act 566 of 2007, and shall be completed in accordance with their respective terms.

A person who purchases an equity interest in a capital development company in any of the calendar years 2003 - 2015 under the Arkansas Capital Development Act is entitled to a credit against any state income tax liability or premium tax liability that may be imposed on the purchaser for any tax year commencing on or after the date of the purchase.

No capital development company shall enter into an agreement or a commitment for the purchase by any person of equity interests in the capital development company on or after July 1, 2007.

XI. Rulemaking Authority

The AEDC and ADFA have authority, at § 15-4-3306, to promulgate rules necessary to implement Act 566 of 2007, as amended.