

**Date of State Budget Office Approval:**

**Date Requested:** Thursday, May 01, 2014

**Date Due:** Sunday, May 11, 2014

**Impact on Expenditures**

FY 2014 n/a  
 FY 2015 n/a  
 FY 2016 n/a

**Impact on Revenues**

FY 2014 n/a  
 FY 2015 See Below  
 FY 2016 See Below

**Explanation by State Budget Office:**

This bill would amend Rhode Island General Law Chapter 44-43 entitled "Tax Incentives for Capital Investment in Small Businesses" by adding to Rhode Island General Law Section 44-43-1 titled "Definitions" the terms Venture Capital Fund and Certified Angel Investor. The bill also amends Rhode Island General Law Section 44-43-2 titled "Deduction or modification" to make a Certified Angel Investor eligible for the provisions of the section. The bill also amends Rhode Island General Law Section 44-43-3 titled "Wage credit" increasing the threshold amount of wages to \$100,000 above which a 3.0 percent credit can be received and the threshold amount of revenue to \$3.0 million that a company can earn above which the credit is no longer allowed. Finally, the bill amends Rhode Island General Law Section 44-43-5 titled "Exemption" to provide for an exemption from the taxes imposed by Rhode Island General Law Chapter 44-11 entitled "Business Corporation Tax", Rhode Island General Law Chapter 44-13 entitled "Public Service Corporation Tax", Rhode Island General Law Chapter 44-14 entitled "Taxation of Banks" and Rhode Island General Law Chapter 44-30 entitled "Personal Income Tax" the amount of long-term capital gain realized by a certified angel investor from an investment in a qualifying business entity.

Under the bill, a Venture Capital Fund, is defined as a "private fund" that "(i) represents to investors and potential investors that it pursues a venture capital strategy; (ii) immediately after the acquisition [of an investment position in a qualifying business],...holds no more than twenty percent (20%) of the amount of the fund's aggregate capital contributions and uncalled committed capital assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, consistently applied by the fund; (iii) does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of fifteen percent (15%) of the private fund's aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than one hundred twenty (120) calendar days, except that any guarantee by the private fund of a qualifying portfolio company's obligations up to the amount of the value of the private fund's investment in the qualifying portfolio company is not subject to the one hundred twenty (120) day calendar limit; (iv) only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and (v) is not registered under section 8 of the Investment Company Act to 1940 (15 U.S.C. 24 80a-8), and has not elected to be

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treated as a business development company pursuant to section 54 of that act (15 U.S.C. 80a-53).”

Under the bill, a Certified Angel Investor, is defined as “(i) a bank, insurance company, registered investment company, business development company, or small business investment company; (ii) an employee benefit plan, within the meaning of the employee retirement income security act, if a bank, insurance company, or registered investment advisor makes the investment decisions, or if the plan has total assets in excess of five million dollars (\$5,000,000); (iii) a charitable organization, corporation, or partnership with assets exceeding five million dollars (\$5,000,000); (iv) a director, executive officer, or general partner of the company selling the securities; (v) a business in which all the equity owners are accredited investors; (vi) a natural person who has net worth, or joint net worth with the person's spouse, that exceeds one million dollars (\$1,000,000) at the time of the purchase, excluding the value of the primary residence of such person; (vii) A natural person with income exceeding two hundred thousand dollars (\$200,000) in each of the two (2) most recent years or joint income with a spouse exceeding three hundred thousand dollars (\$300,000) for those years and a reasonable expectation of the same income level in the current year; or (viii) a trust with assets in excess of five million dollars (\$5,000,000), not formed to acquire the securities offered, whose purposes a sophisticated person makes.”

Under current law, neither a venture capital fund nor a certified angel investor is eligible for the tax incentives provided under Rhode Island General Law Chapter 44-43. Further, under current law, the wage threshold amount above which an investor can earn the 3.0 percent wage credit is \$50,000 and the company revenue threshold amount above which the wage credit no longer applies is \$1.5 million. Finally, under current law, the exemption from the taxes imposed under Rhode Island General Law Chapters 44-11, 44-13, 44-14 or 44-30 for realized long term capital gains is limited to (i) a partner in a certified venture capital partnership, (ii) the distributive share of a partner in a certified venture capital partnership, and (iii) an entrepreneur that has an interest in entity that was a qualifying entity at the time the interest was acquired.

*Comments on  
Sources of Funds:*

All personal income taxes, business corporation taxes, public service corporation taxes, taxes on bank are considered to be general revenues.

*Summary of Facts  
and Assumptions:*

The bill takes effect upon passage but is assumed to apply to tax years beginning on or after January 1, 2014. It is further assumed that revenue changes that result from the passage of the bill would not be realized until the fiscal year following the effective tax year of the bill. That is, the tax year 2014 revenue impact would not be realized until FY 2015, the tax year 2015 revenue impact would not be realized until FY 2016, etc.

Under Rhode Island General Law Section 44-30-2.6(I) for tax years beginning on or after January 1, 2011, only the credits enumerated in Rhode Island General Law Sections 44-30-2.6(I)(a) through 44-30-2.6(I)(i) are allowed against the tax imposed by Rhode Island General Law Chapter 44-30. This bill does not amend Rhode Island General Law Section 44-30-2.6(I) to include the credit allowed in the bill and thus the credit allowed in the bill cannot be used against the Rhode Island personal income tax.

There is no method by which to estimate the fiscal impact of the wage credit portion of the bill as data on the wages paid to the employees of qualifying business entities financed by investments made by either a certified venture capital partnership, which includes a venture capital fund, or a certified angel investor. Additionally, there is no data available on the long term capital gains realized by certified angel investors in Rhode Island. It should be noted that the negative impact on state revenues from passage of the bill could be substantial.

The Rhode Island Department of Revenue's Office of Revenue Analysis (ORA) was able to identify two Rhode Island based certified angel investor companies, Cherrystone Angel Group and Ocean State Angels. Cherrystone Angel Group founded in 2004 has invested in over 16 companies ranging from Narragansett Brewery to MoFuse a global leader in mobile content management. As of November 2013, Ocean State Angels had invested in two companies.

For purposes of context, according to recent press releases Andera Inc., a Providence startup firm, sold for a total of \$48.0 million. Andera Inc. was backed by the taxpayer backed nonprofit Slater Technology Fund, a venture capital fund, which made multiple investments in Andera totaling \$750,000. At the time of sale of Andera to Bottomline Technologies, a New Hampshire company, Slater Technology Fund expected to receive \$3.0 million for their initial investments. As a result, Slater Technology Fund saw a net capital gain of \$2.25 million from investing in this one company (i.e., \$3,000,000 - \$750,000). The \$2.25 million capital gain that Slater is to receive would have been taxed as ordinary income under current law if Slater was subject to state taxes. Based on the current personal income tax system this capital gain would have generated \$134,775 in personal income tax revenue (i.e.;  $\$2,250,000 * 0.0599$ ). Based on the current business corporation tax system this capital gain would have generated \$202,500 (i.e.;  $\$2,250,000 * 0.09$ ). It is easy to see that if, for example, five transactions a year similar to the Andera Inc. transaction were to occur in a given year, the foregone revenue from passage of the bill could be substantial (on the order of \$673,775 to \$1,012,500).

The Governor's FY 2015 Recommended Budget projects a deficit of \$151.5 million in FY 2016. Passage of this act could potentially increase this projected deficit.

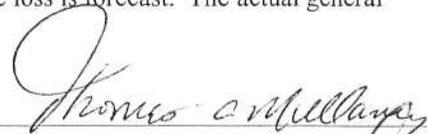
*Summary of Fiscal  
Impact:*

FY 2014: Not applicable given the effective date of the bill.

FY 2015: An indeterminable general revenue loss is forecast. The actual general revenue loss could be substantial.

FY 2016: An indeterminable general revenue loss is forecast. The actual general revenue loss could be substantial.

Budget Office Signature:



Fiscal Advisor Signature:



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