

CHAPTER 2
TAX CREDIT FOR INVESTMENTS IN QUALIFYING BUSINESSES
AND COMMUNITY-BASED SEED CAPITAL FUNDS

123—2.1(15E) Tax credit for investments in qualifying businesses and community-based seed capital funds. For tax years beginning on or after January 1, 2002, a taxpayer may claim a tax credit against the taxpayer's tax liability for personal net income tax imposed under Iowa Code chapter 422, division II, for a portion of the taxpayer's equity investment in a qualifying business. For tax years beginning on or after January 1, 2004, a taxpayer may claim a credit against the taxpayer's tax liability for personal net income tax imposed under Iowa Code chapter 422, division II; business tax on corporations imposed under Iowa Code chapter 422, division III; taxation of financial institutions imposed under Iowa Code chapter 422, division V; insurance companies tax imposed under Iowa Code chapter 432; or taxation of credit unions imposed pursuant to 2007 Iowa Acts, Senate File 557, section 60, for a portion of a taxpayer's equity investment in a qualifying business. For tax years beginning on or after January 1, 2002, a taxpayer may claim a credit against the taxpayer's tax liability for personal net income tax imposed under Iowa Code chapter 422, division II; business tax on corporations imposed under Iowa Code chapter 422, division III; taxation of financial institutions imposed under Iowa Code chapter 422, division V; insurance companies tax imposed under Iowa Code chapter 432; or taxation of credit unions imposed pursuant to 2007 Iowa Acts, Senate File 557, section 60, for a portion of a taxpayer's equity investment in a community-based seed capital fund. For investments made prior to January 1, 2004, only natural persons shall be eligible for the investment tax credit provided for an investment in a qualifying business. For investments made prior to January 1, 2004, a natural person includes an individual taxed on income from a revocable trust. Natural persons and various types of legal entities including, but not limited to, corporations, limited liability companies, partnerships (both general and limited), trusts and estates shall be eligible for the investment tax credit provided for an investment in a community-based seed capital fund and for investments made on or after January 1, 2004, in a qualifying business. If the taxpayer that is entitled to an investment tax credit for an investment in a community-based seed capital fund or a qualifying business is a pass-through entity electing to have its income taxed directly to its individual owners, such as a partnership, limited liability company, S corporation, estate or trust, the pass-through entity shall allocate the allowable credit to each of the individual owners of the entity on the basis of each owner's pro rata share of the earnings of the entity, and the individual owners may claim their respective credits on their individual income tax returns. For investments made prior to January 1, 2004, an individual shall not separately claim a tax credit for an investment in a qualifying business for any tax credit allocated to such individual by a pass-through entity as described in the immediately preceding sentence.

123—2.2(15E) Definitions. The following definitions are applicable to this chapter:

"Affiliate" means a spouse, child, or sibling of an investor or a corporation, partnership, or trust in which an investor has a controlling equity interest or in which an investor exercises management control. For purposes of these rules, "controlling equity interest" means ownership of more than 50 percent of the outstanding equity interests of a corporation, partnership, limited liability company or trust. "Management control" means holding more than 50 percent voting power on any board of directors or trustees, any management committee or any other group managing a corporation, partnership, limited liability company or trust.

"Board" means the Iowa capital investment board created under 2002 Iowa Acts, House File 2078, section 3.

"Community-based seed capital fund" means a fund that meets the following criteria:

1. Is organized as a limited partnership or limited liability company;
2. Has, on or after January 1, 2002, a total of capital commitments from both investors and investments in qualifying businesses of at least \$125,000, but not more than \$3 million. If the fund is either a rural business investment company under the rural business investment program of the federal Farm Security and Rural Investment Act of 2002, or an Iowa-based seed capital fund with at least

40 percent of its committed capital subscribed by community-based seed capital funds, the fund may have more than \$3 million of capital commitments from both investors and investments in qualifying businesses; and

3. Has no fewer than five investors who are not affiliates, with no single investor and affiliates of that investor together owning a total of more than 25 percent of the ownership interests outstanding in the fund.

“*Investor*” means an individual making a cash investment in a qualifying business prior to January 1, 2004, or an individual taxed on income from a revocable trust’s cash investment in a qualifying business prior to January 1, 2004, or a person making a cash investment in a community-based seed capital fund or investments in a qualifying business made on or after January 1, 2004. “Investor” does not include a person who is a current or previous owner, member, partner (limited or general) or shareholder in a qualifying business for investments made prior to January 1, 2004. “Investor” does not include a person that holds at least a 70 percent ownership interest as an owner, member, or shareholder in a qualifying business for investments made on or after January 1, 2004.

“*Near equity*” means debt that may be converted to equity at the option of the debt holder, and royalty agreements.

“*Person*” means an individual, corporation, limited liability company, business trust, estate, trust, partnership or association, or any other legal entity.

“*Professional services*” include, but are not limited to, services provided by professions listed in Iowa Code section 496C.2(4).

“*Qualifying business*” means a business that meets the following criteria:

1. The principal business operations of the business are located in the state of Iowa;
2. The business has been in operation for three years or less from the date of the investment for which a credit is claimed for investments made prior to July 1, 2005, or the business has been in operation for six years or less from the date of the investment for which a credit is claimed for investments made on or after July 1, 2005;
3. The business has an owner who has successfully completed one of the following:
 - An entrepreneurial venture development curriculum, such as programs developed by a John Pappajohn Entrepreneurial Center, or a holistic training program recognized by the Iowa department of economic development which generally encompasses the following areas: entrepreneurial training, management team development, intellectual property management, market research and analysis, sales and distribution development, financial planning and management and strategic planning;
 - Three years of relevant business experience;
 - A four-year college degree in business management, business administration or a related field;
 - Other training or experience sufficient to increase the probability of success of the qualifying business;
4. The business is not a business engaged primarily in retail sales, real estate or the provision of health care or other professional services;
5. The business shall not have a net worth that exceeds \$3 million at the date of the investment for which the credit is claimed for investments made prior to July 1, 2005, or the business shall not have a net worth that exceeds \$10 million for which a credit is claimed for investments made on or after July 1, 2005; and
6. Within 24 months from the first date on which the equity investments qualifying for investment tax credits have been made, the business shall have secured total equity or near equity financing equal to at least \$250,000.

123—2.3(15E) Taxpayers eligible for the investment tax credit. A taxpayer who is a natural person and an investor in a qualifying business or community-based seed capital fund is eligible to apply to the board for an investment tax credit applicable against such taxpayer’s personal net income tax liability imposed under Iowa Code chapter 422, division II. An individual receiving income from a revocable trust’s investment in a qualifying business may claim the tax credit against the taxes imposed under Iowa Code chapter 422, division II, for a portion of the revocable trust’s equity investment in a

qualifying business. A taxpayer that is a legal entity, such as a corporation, limited liability company, partnership (general or limited), trust or estate, and is an investor in a community-based seed capital fund or an investor in a qualifying business for investments made on or after January 1, 2004, is eligible to apply to the board for an investment tax credit applicable against such taxpayer's tax liability under the business tax on corporations imposed under Iowa Code chapter 422, division III; the taxation of financial institutions imposed under Iowa Code chapter 422, division V; the insurance companies tax imposed under Iowa Code chapter 432; or the taxation of credit unions imposed pursuant to 2007 Iowa Acts, Senate File 557, section 60. The taxpayer's investment must be made in the form of cash to purchase equity in a qualifying business or community-based seed capital fund.

123—2.4(15E) Application for the investment tax credit. A taxpayer that desires to receive an investment tax credit for an equity investment in a qualifying business or community-based seed capital fund must submit an application to the board for approval and provide such other information and documentation as may be requested by the board. Application forms for the investment tax credit may be obtained by contacting the Iowa capital investment board at the Iowa Department of Revenue, 1305 E. Walnut Street, Hoover State Office Building, Des Moines, Iowa 50319. The telephone number is (515)281-3204. Application forms may also be obtained by contacting a Small Business Development Center in the applicant's geographic location. The board shall coordinate with Small Business Development Centers throughout the state to provide uniform application forms to Small Business Development Centers and to disseminate information regarding the investment tax credits. The board shall provide a summary of the investment tax credits to Small Business Development Centers by either supplying the Small Business Development Centers with a copy of these rules or delivering substantially similar information in any other format approved by the board. The board shall make itself accessible to Small Business Development Centers for assistance with questions concerning completion of applications or any other questions pertaining to the investment tax credits. Applications shall be submitted to the board in care of the department of revenue at the address identified above. Applications shall be date- and time-stamped by the department of revenue in the order in which such applications are received. Applications for the investment tax credit shall be accepted by the board until March 31 of the year following the calendar year in which the taxpayer's equity investment was made.

EXAMPLE 1: A taxpayer makes an equity investment in a qualifying business on December 31, 2002. The taxpayer has until March 31, 2003, to apply to the board for an investment tax credit.

EXAMPLE 2: A taxpayer makes an equity investment in a qualifying business on July 1, 2003. The taxpayer has until March 31, 2004, to apply to the board for an investment tax credit.

123—2.5(15E) Verification of qualifying businesses and community-based seed capital funds.

2.5(1) Qualifying businesses. Within 120 days from the first date on which the equity investments qualifying for investment tax credits have been made (or, for investments made during the 2002 calendar year, by the later of 120 days from the first date on which the investments have been made or March 31, 2003), a qualifying business shall provide to the board the following information as a prerequisite to the board's issuance of any investment tax credits to investors in such qualifying business:

a. A signed statement, from an officer, director, manager, member, or general partner of the qualifying business, that contains a description of the general nature of its business operations, the location of the principal business operations, the date on which the business was formed, and the date on which the business commenced operations;

b. A balance sheet, certified by the chief executive officer and the chief financial officer of the qualifying business, that reflects the qualifying business's assets, liabilities and owners' equity as of the close of the most recent month or quarter;

c. A signed statement, from an owner of the business, that describes the manner in which such owner satisfies one of the training requirements set forth in the definition of a qualifying business under rule 123—2.2(15E);

d. A signed statement, from an officer, director, manager, member or general partner of the qualifying business, that states the names, addresses, shares or equity interests issued, consideration

paid for the shares or equity interests, and the amounts of any tax credits, of all shareholders or equity-holders who may initially qualify for the tax credits, and the earliest year in which the tax credits may be redeemed. The statement shall contain a commitment by the qualifying business to amend its statement as may be necessary from time to time to reflect new equity interests or transfers in equity among current equity-holders or as any other information on the list may change; and

e. A certificate of existence of a business plan for the qualifying business which details the business's growth strategy, management team, production/management plan, marketing plan, financial plan and other standard elements of a business plan.

Upon the board's receipt of the information and documentation necessary to demonstrate satisfaction of the criteria set forth herein, the board shall, within a reasonable period of time, determine whether a business is a qualifying business. If the board verifies that the business is a qualifying business, the board shall register the qualifying business on a registry of such qualifying businesses. The board shall maintain the registry and use it to authorize the issuance of further investment tax credits to taxpayers who make equity investments in qualifying businesses registered with the board. The board shall issue written notification to the qualifying business and the applicant that such business has been registered as a qualifying business with the board for the purpose of issuing investment tax credits but that such registration is subject to removal and rescission under rule 123—2.9(15E) for any failure of the business to continuously satisfy the requirements necessary for verification and registration as a qualifying business.

2.5(2) Community-based seed capital funds. Within 120 days from the first date on which the equity investments qualifying for investment tax credits have been made (or, for investments made during the 2002 calendar year, by the later of 120 days from the first date on which the investments have been made or March 31, 2003), a community-based seed capital fund shall provide to the board information as a prerequisite to the board's issuance of investment tax credits to investors in such community-based seed capital fund. Funds which could not meet the threshold of \$500,000 in capital commitments but are able to meet the threshold of \$125,000 of capital commitments as set forth in 2004 Iowa Acts, chapter 1148, shall have until December 31, 2004, to provide information to the board. A community-based seed capital fund cannot invest in the Iowa fund of funds organized by the Iowa capital investment corporation under Iowa Code section 15E.65, but may invest up to 60 percent of its committed capital in an Iowa-based seed capital fund with at least 40 percent of its committed capital subscribed by community-based seed capital funds. The following information must be provided:

a. A copy of the fund's certificate of limited partnership, limited partnership agreement, articles of organization or operating agreement or both certified by the chief executive officer of the community-based seed capital fund.

b. A signed statement, from an officer, director, manager, member or general partner of the fund, that states the total amount of capital contributions or capital commitments from investors and the total number of individual investors that are not affiliates and the ownership interest of each individual investor in the fund.

c. A signed statement, from an officer, director, manager, member or general partner of the fund, that states the names, addresses, equity interests issued, consideration paid for the interests and the amounts of any tax credits, of all limited partners or members who may initially qualify for the tax credits, and the earliest year in which the tax credits may be redeemed. The statement shall also contain a commitment by the fund to amend its statement as may be necessary from time to time to reflect new equity interests or transfers in equity among current equity-holders or as any other information on the list may change.

Upon the board's receipt of the information and documentation necessary to demonstrate a community-based seed capital fund's satisfaction of the criteria set forth herein, the board shall, within a reasonable period of time, determine whether a fund is a community-based seed capital fund. If the board verifies that the fund is a community-based seed capital fund, the board shall register the community-based seed capital fund on a registry of such community-based seed capital funds. The board shall maintain the registry and use it to authorize the issuance of further investment tax credits to taxpayers that make equity investments in the community-based seed capital funds registered with

the board. The board shall issue written notification to the community-based seed capital fund and the applicant that such fund has been registered as a community-based seed capital fund with the board for the purpose of issuing investment tax credits but that such registration is subject to removal and rescission under rule 123—2.9(15E) for any failure of the community-based seed capital fund to continuously satisfy the requirements necessary for verification and registration as a community-based seed capital fund.

123—2.6(15E) Issuance and distribution of investment tax credits. Upon verification and registration by the board of a qualifying business or community-based seed capital fund and approval of the taxpayer's application, the board shall issue a tax credit certificate to the applicant, provided, however, that such tax credit certificate shall be subject to rescission by the board pursuant to rule 123—2.9(15E). The tax credit certificate shall be in a form approved by the board and shall contain the taxpayer's name, address, and tax identification number, the amount of credit, the name of the qualifying business or community-based seed capital fund, the year in which the credit may be redeemed and any other information that may be required by the department of revenue. In addition, the tax credit certificate shall contain the following statement:

The Iowa Capital Investment Board has not recommended or approved this investment or passed on the merits or risks of such investment. Investors should rely solely on their own investigation and analysis and seek investment, financial, legal and tax advice before making their own decision regarding investment in this enterprise.

A tax credit shall equal 20 percent of the taxpayer's equity investment in a qualifying business or community-based seed capital fund. The maximum amount of a tax credit for an investment by an investor in any one qualifying business shall be \$50,000. Each year, an investor and all affiliates of the investor shall not claim tax credits under this rule for more than five different investments in five different qualifying businesses. An investor in a community-based seed capital fund shall receive a tax credit pursuant to this rule only for the investor's investment in the community-based seed capital fund and shall not receive any additional tax credit for the investor's share of investments in a qualifying business made by the community-based seed capital fund or in an Iowa-based seed capital fund with at least 40 percent of its committed capital subscribed by community-based seed capital funds. However, an investor in a community-based seed capital fund may receive a tax credit under this rule with respect to a separate direct investment made by the investor in the same qualifying business in which the community-based seed capital fund invests.

The aggregate amount of tax credits issued pursuant to this rule shall not exceed a total of \$10 million. The total amount of tax credits issued during the fiscal year beginning July 1, 2002, shall not exceed \$3 million. The total amount of tax credits issued during the fiscal year beginning July 1, 2003, shall not exceed \$3 million. The total amount of tax credits issued during the fiscal year beginning July 1, 2004, shall not exceed \$4 million. Any amount of the \$10 million of total tax credits that have not been issued by June 30, 2005, may be issued for a fiscal year beginning July 1, 2005, and for any other subsequent fiscal years until the \$10 million limitation is met. No more than \$3 million of tax credits may be issued for any one fiscal year beginning July 1, 2005, and for any subsequent fiscal year. If, during any fiscal year during which tax credits are to be issued under this rule, applications are approved for more than the amount of credits authorized by 2002 Iowa Acts, chapter 1006, section 3(4), the applicants shall receive tax credit certificates on a first-come, first-served basis, until the amount of credits authorized for issuance has been exhausted. Any tax credits approved but unissued shall be carried over to the next fiscal year, and the board shall, during the next fiscal year, give priority to applicants' tax credits carried over from a prior fiscal year by (1) issuing tax credit certificates to the taxpayers for such carryover tax credits before issuing any new tax credits; and (2) applying the aggregate amount of the credits carried over against the total amount of tax credits to be issued during such fiscal year before approving or issuing new tax credits.

123—2.7(15E) Claiming the tax credits. A taxpayer shall not claim the tax credit prior to the third tax year following the tax year in which the investment is made. An investment shall be deemed to have

been made on the same date as the date of acquisition of the equity interest as determined by the Internal Revenue Code. An investment made prior to January 1, 2002, shall not qualify for a tax credit under this rule. A tax credit shall not be redeemed during any tax year beginning prior to January 1, 2005. A tax credit shall not be transferable to any other taxpayer. Any tax credit in excess of the taxpayer's liability for the tax year may be credited to the tax liability for the following five years or until depleted, whichever is earlier. Notwithstanding the foregoing, any tax credit carried over pursuant to rule 123—2.6(15E) and issued for the tax year immediately following the tax year in which the investment was made may be claimed by the taxpayer and credited to the taxpayer's tax liability for the third tax year following the tax year in which the tax credit is issued. A tax credit shall not be carried back to a tax year prior to the tax year in which the taxpayer redeems the tax credit. In the case of a tax credit allowed under Iowa Code chapter 422, division II, where the taxpayer died prior to redeeming the tax credit, the remaining credit can be redeemed on the decedent's final income tax return.

123—2.8(15E) Notification to the department of revenue. Upon the issuance and distribution of investment tax credits for each tax year, the board shall notify the department of revenue by providing copies of the tax credit certificates issued for such tax year to the department of revenue. Such notification shall also include, but not be limited to, the aggregate number and amount of tax credits issued for such tax year.

123—2.9(15E) Rescinding the tax credits. Within 24 months from the first date on which the equity investments qualifying for investment tax credits have been made, a qualifying business shall provide to the board information and documentation sufficient to demonstrate that the business has secured total equity or near equity financing equal to at least \$250,000. Examples of sufficient information and documentation include, but are not limited to, corporate, partnership or limited liability company-certified resolutions setting forth the names of individuals or entities making capital contributions and the amounts of such capital contributions or certified corporate, partnership, or limited liability company minutes reflecting the names of individuals or entities making capital contributions and the amounts of such capital contributions. On or by the last day of the 24-month period described herein, a qualifying business shall certify to the board, by a statement signed by an officer, director, member, manager, or general partner of the qualifying business, that it has secured the requisite amount of equity financing required by this rule within the time period prescribed by this rule and shall recertify to the board that the qualifying business continues to meet the requirements set forth in 123—subrule 2.5(1). In the event that a qualifying business fails to meet or maintain any requirement set forth in this rule, including, without limitation, timely filing of the certifications described in the preceding sentence of this rule, the board shall rescind any tax credit certificates issued to those taxpayers and shall notify the department of revenue that it has done so, and the tax credit certificates shall be null and void. In addition, the board shall remove such qualifying business from its registry and shall issue written notification of such removal to the qualifying business and the applicants.

A community-based seed capital fund shall have invested at least 33 percent of its invested capital in one or more separate qualifying businesses on or by the last day of the 48-month period that commences with the fund's investing activities. On or by the last day of the 48-month period described under this rule, a community-based seed capital fund shall certify to the board, by a statement signed by an officer, director, member, manager, or general partner of the community-based seed capital fund, that it has met the requirements of this rule within the time period prescribed by this rule and shall recertify to the board that the community-based seed capital fund continues to meet the requirements set forth in 123—subrule 2.5(2). In the event that a community-based seed capital fund fails to meet or maintain any requirement set forth in this rule, including, without limitation, timely filing of the certifications described in the preceding sentence of this paragraph, the board shall rescind any tax credit certificates issued to limited partners or members and shall notify the department of revenue that it has done so, and the tax credit certificates shall be null and void. In addition, the board shall remove such community-based seed capital fund from its registry and shall issue written notification of such removal to the community-based seed capital fund and the applicants. Notwithstanding the foregoing, a community-based seed capital fund

may apply to the board for a one-year waiver from the requirements of this rule. The board shall, upon review of a community-based seed capital fund's application for waiver, exercise reasonable discretion in granting or denying such waiver. In the event that the board grants to a community-based seed capital fund a one-year waiver from the requirements of this rule, the board shall defer any rescission of the tax credit certificates until the expiration of such one-year waiver period. If the community-based seed capital fund meets the requirements of this rule by the expiration of such one-year waiver period, the tax credit certificates shall not be rescinded, but the tax credit certificates shall be rescinded at the end of such one-year waiver period if such requirements have not been met.

In the event a taxpayer has claimed an investment tax credit for an investment in a qualifying business under 2002 Iowa Acts, chapter 1006, section 3(1) "a," or for an investment in a community-based seed capital fund under 2002 Iowa Acts, chapter 1006, section 3(1) "b," and such tax credit has been rescinded under the provisions of this rule, the department of revenue shall assess a deficiency against the taxpayer for the tax credit claimed upon receipt of written notice of the rescission of such tax credit by the board.

123—2.10(15E) Additional information. The board retains the authority to request additional information and documentation from a qualifying business or community-based seed capital fund regarding the operations, job creation and economic impact of such qualifying business or community-based seed capital fund, and the board may use such information in preparing and publishing any reports to be provided to the governor and the general assembly.

These rules are intended to implement Iowa Code chapter 15E and 2007 Iowa Acts, House File 923.

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