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State of South Carolina  
**Department of Revenue**  
300A Outlet Pointe Blvd., Columbia, South Carolina 29210  
P.O. Box 125, Columbia, South Carolina 29214

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SC REVENUE RULING #14-6

**SUBJECT:** Angel Investor Credit  
(Income Tax)

**EFFECTIVE DATE:** September 1, 2014

**SUPERSEDES:** All previous documents and any oral directives in conflict herewith.

**REFERENCES:** Chapter 44, Title 11 (Supp. 2013)

**AUTHORITY:** S.C. Code Ann. Section 12-4-320 (2014)  
S.C. Code Ann. Section 1-23-10(4) (2005)  
SC Revenue Procedure #09-3

**SCOPE:** The purpose of a Revenue Ruling is to provide guidance to the public. It is an advisory opinion issued to apply principles of tax law to a set of facts or a general category of taxpayers. It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Department advisory opinion.

**INTRODUCTION**

The "High Growth Small Business Job Creation Act of 2013" was enacted in Title 11, Chapter 44 to improve the availability of early stage capital for emerging high-growth enterprises in South Carolina. To further this goal, the Act encourages individual angel investors to invest in early stage, high-growth, job-creating businesses by providing an angel investor an income tax credit of 35% of its qualified investment. The total credit an individual is allowed for all investments in one tax year is \$100,000. Only 50% of the allowed credit can be used against the individuals net income tax liability in the tax year the qualified investment is made. The credit has a 10 year carry forward.

The Act contains numerous definitions, including “angel investor,” “pass through entity,” “qualified investment,” and “qualified business,” and contains specific rules and requirements for an investor to be eligible for the credit and for a business to be qualified to receive an investment eligible for the credit. Since the total credit allowed to all taxpayers is limited to \$5 million in any year, an angel investor seeking to claim the credit must submit an application to the Department for approval by December 31 of the year the investment was made. Applications submitted after this date will not be considered for credit approval. If the credit amounts on all of the applications received by the Department exceed \$5 million, then the Department must allocate the credit on a pro rata basis among the angel investors who filed a timely application.

Upon notification to the Department, a credit can be sold or transferred one time to any taxpayer. Special rules exist for the claiming of the credit by the transferee.

Complex rules exist upon the sale or exchange of the qualified investment (i.e., the stock or debt in the qualified business) by the individual who was originally eligible to claim the credit.

The purpose of this advisory opinion is to provide general guidance regarding the provisions of the Act. This document contains the following parts:

Part I – Original Investor Guidance – Qualifications, Requirements, and Claiming the Credit

Part II – Transfer of Credit – Notification to the Department and Claiming the Credit

Part III – Sale of an Angel Investor Credit Asset

## **PART I – ORIGINAL INVESTOR GUIDANCE**

### **Angel Investor Definition and Qualifications**

1. Q. What is the definition of an “angel investor”?

A. An angel investor is:

- a. An individual<sup>1</sup> person subject to South Carolina income taxes imposed by Chapter 6, Title 12, who is an “accredited investor” as defined by the United States Securities and Exchange Commission (see Part I, Question 5) or
- b. A pass through entity that (1) is formed for investment purposes, (2) has no business operations, (3) does not have committed capital<sup>2</sup> under management over \$5 million, (4) is not capitalized with funds raised or pooled through private placement memoranda directed to institutional investors, and (5) is an “accredited investor” as defined by the United States Securities and Exchange Commission (see Part I, Question 5).

Note: An angel investor cannot be a venture capital fund or commodity fund with institutional investors or a hedge fund. Code Section 11-44-30(1).

2. Q. What is the definition of a “pass through entity”?

A. A pass through entity is a partnership, S corporation, or a limited liability company taxed as a partnership or S corporation. Code Section 11-44-30(4).

3. Q. Can an entity disregarded for South Carolina tax purposes, such as a grantor trust or single member limited liability company, meet the definition of an angel investor?

A. Yes, provided the sole member or grantor meets all the requirements in Chapter 44, Title 11 to qualify for the credit. Code Section 12-2-25 provides that certain entities are disregarded for tax purposes (*i.e.*, the entity is not treated as a separate entity from its owner.) For example, if a single member limited liability company does not make a federal election to be taxed as a corporation, it will not be treated

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<sup>1</sup>SC Code Section 12-2-20 defines “individual” as a human being.

<sup>2</sup>In general, “committed capital” is an agreement that obligates the investor to contribute money to the investment entity. The investor may pay all of the committed capital at one time, or make contributions over a period of time.

as a separate entity. Instead, it will be treated as a sole proprietorship if owned by an individual, a division of the corporation if owned by a corporation, or a division of the partnership if owned by a partnership.

Disregarded entities that may meet the definition of an angel investor include:

- a. a single member limited liability company which is not taxed for South Carolina income tax purposes as a corporation and
- b. a grantor trust.

4. Q. What type of entity does not qualify as an angel investor?

A. Examples of entities that do not meet the definition of angel investor include a C corporation, a limited liability company taxed as a C corporation, and a trust that is not a grantor trust. Code Sections 11-44-30(1) and (4).

5. Q. How is the term “accredited investor” defined by the United States Securities and Exchange Commission?

A. South Carolina law requires that an angel investor be an accredited investor as defined by the United States Securities and Exchange Commission (SEC). For federal purposes, a company that offers or sells its securities must register the securities with the SEC or find an exemption from the registration requirements. For some of the exemptions, a company may sell its securities to “accredited investors.” Below is a summary of the federal regulations defining accredited investor<sup>3</sup> used in determining whether an individual or pass through entity meets the definition of angel investor.

- a. A natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1 million, excluding the value of the person’s primary residence;
- b. A natural person who had an individual income exceeding \$200,000 in each of the two most recent years or joint income with that person’s spouse exceeding \$300,000 in each of those years and has a reasonable expectation of the same income level in the current year;

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<sup>3</sup> The federal securities laws define accredited investor in 17 C.F.R. § 230.501(a). Note: Tax credits generated as a result of these investments are not considered securities under South Carolina law. Code Section 11-44-80.

- c. A director, executive officer, or general partner of the issuer of the securities, or any director, executive officer, or general partner of a general partner of the issuer;
- d. A partnership, corporation, business trust, or Internal Revenue Code 501(c)(3) organization, not formed for the specific purpose of acquiring the securities offered, with total assets exceeding \$5 million;
- e. Any entity in which all the equity owners are accredited investors. (See Question 6);
- f. A trust, with total assets exceeding \$5 million, not formed for the specific purpose of acquiring the securities, whose purchase is made by a sophisticated person;
- g. A bank, savings and loan association, insurance company, registered investment company, business development company, or small business investment company; or
- h. An employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, savings and loan association, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets exceeding \$5 million or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors.

Caution: Although the above are accredited investors, some do not meet the definition of “angel investor” discussed in Part I, Question 1. An individual or pass through entity must meet all the requirements in Chapter 44, Title 11 to qualify for the credit.

- 6. Q. How does an angel investor that is a pass through entity verify its SEC accredited investor status that it is “an entity in which all the equity owners are accredited investors”?
- A. When determining accredited investor status, if the pass through entity meets the SEC requirement only because it is an entity in which all the equity owners are accredited investors, then the pass through entity making the investment must review every level of entity ownership to verify all equity owners are accredited investors.

If any partner, shareholder, or member at any level of ownership does not meet the accredited investor requirement, then the pass through entity making the investment does not meet the definitions of “accredited investor” or “angel investor” and no credit is allowed for the investment.

## **Qualified Investment Definition and Requirements**

7. Q. What is a “qualified investment”?

A. A qualified investment is an investment by an angel investor of either:

- a. a cash investment in a qualified business for common or preferred stock or an equity interest or
- b. a purchase for cash of subordinated debt in a qualified business.

Investment of common or preferred stock or an equity interest or purchase of subordinated debt does not qualify if a broker fee or commission or a similar remuneration is paid or given directly or indirectly for soliciting an investment or purchase. Code Section 11-44-30(6).

8. Q. Can an investor make multiple qualified investments in a qualified business or invest in more than one qualified business?

A. Yes. Neither the number of qualified investments an angel investor can make in any qualified business nor the dollar amount of qualified investments is limited. The total credit, however, allowed an individual for all its qualified investments is limited to \$100,000 per year, excluding carry forward amounts. See Part I, Question 22. Code Section 11-44-50(2).

9. Q. Can a husband and wife each make a qualified investment?

A. Yes, however, the maximum credit allowed each spouse for all his or her “qualified investments” is limited to \$100,000 per year. See Part I, Question 22. Code Section 11-44-50(2).

10. Q. Can an angel investor's investment in a business in which he, or a related party, has an ownership interest qualify for the credit?

A. Yes, providing all credit requirements are met. Code Section 11-44-30(6).

11. Q. Can an investment be made at any time and qualify for the credit?

A. No. To be a qualified investment, the angel investor must make an investment in a qualified business "registered" with the South Carolina Secretary of State under the High Growth Small Business Job Creation Act. A registered business is one that has been certified by the Secretary of State as a qualified business at the time of application to the Secretary. Investments made before the date a business is certified by the Secretary of State do not qualify for the credit. Code Sections 11-44-30(5) and (7).

### **Qualified Business Definition and Requirements**

12. Q. What businesses can be certified by the Secretary of State to raise capital from an angel investor?

A. An angel investor must invest in a "qualified business." A qualified business is a business that meets all of the requirements listed below.

- a. Is registered as a "qualified business" with the South Carolina Secretary of State (See Part I, Question 13) (Note: This registration differs from registration with the Secretary of State to do business in South Carolina or filing articles of organization with the Secretary of State, etc.);
- b. Is a corporation, limited liability company, or partnership located in South Carolina;
- c. Has its headquarters<sup>4</sup> located in South Carolina at the time the qualified investment is made;
- d. Was organized 5 years or less prior to the qualified investment;

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<sup>4</sup> Headquarters is the facility or portion of a facility where corporate staff employees are physically employed, and where the majority of the company's or company business unit's financial, personnel, legal, planning, information technology, or other headquarters related functions are handled. Code Section 11-44-30(2).

- e. Employs 25 or less people in South Carolina at the time it is registered with the Secretary of State under this Act as a qualified business;
- f. Had gross income of \$2 million or less on a consolidated basis as determined in accordance with the Internal Revenue Code in any complete year before registration;
- g. Is primarily engaged in: (1) manufacturing, (2) processing, (3) warehousing, (4) wholesaling, (5) software development, (6) information technology services, (7) research and development, or (8) a business providing services listed in Code Section 12-6-3360(M)(13) of the job tax credit statute, (i.e., ambulatory health care service, hospital, or residential care facility), other than those described in item (h) below; and
- h. Does not substantially engage<sup>5</sup> in: (1) retail sales, (2) real estate or construction, (3) professional services, (4) financial brokerage, investment activities, or insurance, (5) natural resource extraction, (6) gambling, or (7) entertainment, amusement, recreation, or athletic or fitness activity for which an admission or fee is charged. Code Section 11-44-30(5).

13. Q. How does a business register with the Secretary of State as a “qualified business”?

- A. To be eligible to raise capital from an angel investor, a business must first register with, and receive approval from, the Secretary of State as described in this Act. Approval of this registration constitutes certification for 12 months after being issued. A business is permitted to renew its registration with the Secretary of State if, at the time of renewal, the business remains a qualified business. Code Sections 11-44-30(7) and 11-44-60(A).

See the South Carolina Secretary of State website at [www.scsos.com](http://www.scsos.com) for information on registering as a qualified business.

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<sup>5</sup> A business is “substantially engaged” in an activity if its gross revenue from an activity exceeds 25% of its gross revenues in a year or it is established pursuant to its articles of incorporation, articles of organization, operating agreement, or similar organizational documents to engage as one of its primary purposes such activity. Code Section 11-44-30(5).



14. Q. How does an angel investor know if a business has been certified by the Secretary of State as a qualified business under the Act?

A. An investor should check with the business it is seeking to invest in to verify whether it is currently approved by the Secretary of State as a qualified business. The Secretary of State will issue a qualified business a letter certifying that it is registered under the Act.

In addition, the Secretary of State posts a “Qualified Business Report” on its website, [www.scsos.com](http://www.scsos.com), which lists the name and registration date of each qualified business by county. This list is updated as of January each year. The registration is effective for 12 months after being issued.

Caution: If a business is not currently registered under the Act at the time the angel investor makes an investment, this investment is not eligible for the credit. Code Section 11-44-60(D).

15. Q. Can the Secretary of State revoke its approval of a business as a “qualified business” for purposes of the credit?

A. Yes. If the Secretary of State finds that any information contained in the registration application is false, the Secretary of State may revoke the registration of the business under the Act. Code Section 11-44-60(B).

### **Original Credit Approval and Use**

16. Q. Why does an angel investor have to apply with the Department to receive approval of the credit amount?

A. Since the total credit allowed is \$5 million for all taxpayers in any calendar year, an angel investor seeking to claim a credit must apply to the Department to obtain approval for the credit. If the credit amounts on timely filed applications exceed \$5 million, then the Department will allocate credits on a pro rata basis. Code Sections 11-44-50(1), 11-44-70(A), and 11-44-70(C).

17. Q. What form is used to apply to the Department to obtain approval to claim the credit?

A. Form TC-56A, Application for Angel Investor, is used by the angel investor to obtain approval from the Department.

If the angel investor is an individual, the individual should submit Form TC-56A. If a husband and wife each make a separate investment, then each spouse should submit Form TC-56A.

If the angel investor is a pass through entity, the pass through entity should submit Form TC-56A; each partner, shareholder, or member of the pass through entity does not separately apply.

18.Q. What is the time period for the angel investor to submit an approval application to the Department?

A. The angel investor may submit Form TC-56A to the Department at any time after the qualified investment is made but must submit the application by December 31 of the calendar year the investment was made. Applications submitted after this date will **not** be considered for credit approval.

19.Q. Who does the Department notify that the credit is or is not approved and when does the Department provide the notification?

A. The Department will notify the individual angel investor or the pass through entity angel investor making the direct investment of the tax credit amount approved for the qualified investment. The Department does **not** notify each partner, member, or shareholder of a pass through entity.

Notification of the credit approval or denial will be sent by the Department by January 31 of the year following the investment.

Note: If an individual is a partner, shareholder, or member of more than one pass through entity angel investors, he should be aware that the Department will send a credit approval notice to each pass through entity angel investor. Each pass through entity angel investor is then responsible for notifying the individual of his allocated credit amount for that angel investor. The individual claiming the credit, or credits for multiple investments, is responsible for determining his total credit amount and credit limitations on his tax return.

20. Q. Does the Department's notification of a credit amount mean it cannot be audited?

A. No. Notification to the angel investor is based upon the credit application information provided at the time. The application and credit amount may be audited at a future date for periods open under the statutory time limitation. Code Section 12-54-85.

21. Q. What form is used to compute and claim the credit?

A. Form TC-56, "Angel Investor Credit," is used by an individual to compute and claim the credit.

22. Q. What is the credit amount?

A. An angel investor is entitled to an income tax credit of 35% of its qualified investment. The aggregate amount of credit allowed an individual for one or more qualified investments, whether made directly by the individual or directly by a pass through entity and allocated to an individual, in one tax year cannot exceed \$100,000, excluding carry forward amounts. Amounts in excess of the credit maximum are not allocated or available for use in any year. Code Sections 11-44-40(A) and 11-44-50(2).

23. Q. Are all owners of a qualified pass through entity angel investor eligible for the credit?

A. Only those owners who are individuals qualify. Others who are not individuals do not qualify and may not reallocate, sell, or transfer their proportionate share of the credit.

For example, a partnership angel investor has an individual, an S corporation (owned by two individuals), and a C corporation as partners. Only the individuals (i.e., the individual partner and the individual shareholders of the S corporation) are entitled to their proportionate share of the credit. The C corporation and its shareholders, including shareholders who are individuals, are not entitled to any credit and have no credit to sell, transfer or otherwise allocate. Code Sections 11-44-30 and 11-44-40.

24. Q. How is a pass through entity angel investor required to allocate the credit to its individual partners, shareholders, or members?

A. The pass through entity angel investor must make an irrevocable election with the Department as to the manner the credit is to be allocated. Each individual who is a partner, shareholder, or member of the pass through entity making an investment directly in a qualified business must be allocated the credit allowed in an amount determined in the same manner as the proportionate shares of income or loss of such pass through entity would be determined.

If an individual's share of the pass through entity's credit is limited for a tax year due to the maximum allowable credit under this Act, the pass through entity and its owners may **not** reallocate the unused credit among the other owners. Code Section 11-44-4(C).

25. Q. Does the original investor claim the entire credit in the year of investment?

A. No. Fifty percent of the allowed credit may be applied to the angel investor's "net income tax liability" for the tax year during which the qualified investment is made. Fifty percent of the allowed credit may be applied to the "net income tax liability" in the tax years after the "qualified investment" is made. Code Section 11-44-40(B).

"Net income tax liability" is defined as the individual's South Carolina income tax liability reduced by all other credits allowed under Title 12 (Taxation), Title 11 (Public Finance) and Title 48 (Environmental Protection and Conservation). Code Sections 11-44-30(3) and 11-44-50(3).

At this time, credits allowed under Title 11 and Title 48, include the Venture Capital Investment Credit (Chapter 45, Title 11), Credit for Contribution to the Hydrogen Infrastructure Development Fund (Code Sections 11-46-30 and 12-6-3630), and Energy Efficient Manufactured Home Credit (Code Section 48-52-870).

26. Q. What is the credit carry forward period?

A. Any unused credit may be carried forward for 10 years from the tax year the investment is made. Code Section 11-44-50(3).

27. Q. What is the repeal date?

A. The Act is repealed on December 31, 2019. Any credit carry forward will continue to be allowed until the 10 year period is completed.

**PART II - TRANSFER OF CREDIT – NOTIFICATION TO THE DEPARTMENT AND CLAIMING THE CREDIT**

1. Q. Can an angel investor income tax credit be sold or transferred?

A. Yes. The income tax credit available may be sold, exchanged, or otherwise transferred. Amounts in excess of the \$100,000 credit maximum are not available for transfer. Code Section 11-44-50(5).

2. Q. Can a credit be transferred more than one time?

A. No. The entire credit, or any portions of a credit, may be transferred only once.

However, a “transfer” by the angel investor to his heirs and legatees upon his death and to his spouse or incident to divorce is not considered a one-time transfer. Notification of such event should be provided to the Department prior to any heir, legatee, or former spouse claiming the credit to assist in proper processing. Notification should again be made to the Department subsequent to an heir, legatee, or former spouses’ one time transfer all or a portion of his credit. See Part II, Question 12 below for notification procedures. Code Sections 11-44-50(4) and (5).

3. Q. Can the original credit be transferred to any person or entity and what taxes may the transferred credit be used against?

A. Yes. The credit may be transferred to any person or entity. The transferred credit remains a credit for use against a transferee’s South Carolina income tax only and is nonrefundable. Code Sections 11-44-40(A) and 11-44-50(5).

4. Q. Can the transfer involve more than one transferee?

A. Yes.

5. Q. When and how does a transferor notify the Department of a credit transfer?
- A. The transferor must notify the Department in writing within 30 days of the transfer; the Department does not have a pre-printed form for this notification. The request will be deemed approved two weeks after the transferor has submitted all information requested below in complete form and the transfer is carried out consistently with the information submitted in the request. Failure of the transferor to notify the Department of the transfer results in disallowance of the transferred credit until the transferor complies. See Part II, Question 12 below for the information that must be provided in the notification.
6. Q. What form is used to claim a transferred credit?
- A. The transferee claims a transferred credit on Form 1040TC, "Tax Credits," or 1120-TC, "Corporate Tax Credits." A transferred credit is not reported on Form TC-56, "Angel Investor Credit."
7. Q. When can a credit be transferred?
- A. A credit can be transferred any time after the original angel investor has been notified of the credit amount by the Department (see Part I, Question 19 above.) Further, a credit can be transferred even if the credit has not been claimed by the original angel investor on his tax return in Year 1.
8. Q. Is there a maximum credit amount that a transferee may claim per year?
- A. No. The annual \$100,000 aggregate credit amount applicable to the original angel investor (see Part I, Question 22 above) does not apply to the transferee of that credit. Code Sections 11-44-50(2) and 11-44-50 (5).
9. Q. Can the transferee claim the entire credit in the year of transfer?
- A. Yes. A taxpayer to whom a credit has been transferred may use all of the credit for the tax year in which the transfer occurred. There is no requirement that the transferee may claim only 50% of the credit in the year of the transfer nor is there a requirement that transferee's "net income tax liability" be reduced by all other credits allowed under Title 11, 12, and 48 before claiming the credit. Code Sections 11-44-30(3), 11-44-40(B), 11-44-50(3) and 11-44-50(5).

10. Q. What is the credit carry forward period for a transferred credit?

A. A transfer does not extend the time a credit can be used. A transferred credit may not be used more than 10 years after the credit was originally issued. Code Section 11-44-50(5).

11. Q. What if the transferor has no right to claim or use the credit at the time of the transfer?

A. The credit will be disallowed. The transferee's recourse is against the transferor.

12. Q. How does a transferor notify the Department of a transfer of all or a portion of the credit?

A. The transferor must send a written "notice of transfer" to the Department containing the following information:

1. The complete name, address, telephone number and the taxpayer identification number of the transferor of the credit;
2. The complete name, address, telephone number and taxpayer identification number of each transferee of the credit;
3. A statement that this portion of the credit has not been transferred before;
4. The total amount of credit currently available to the transferor (*i.e.* the total amount of credit less any credits to be used or used by the transferor in the current or prior tax years);
5. The date the original credit was issued;
6. The date the transfer of the credit will be made;
7. The amount of the credit to be transferred;
8. The transferor must provide a waiver of the right to claim that portion of the credit being transferred;
9. The transferors remaining credit balance after the transfer; and,

10. Any other information requested by Department.

The written notice should be mailed to:

Angel Investor Credit Transfer Notice  
Research and Forms Development  
Department of Revenue  
Columbia, SC 29214-0019

The written notice of transfer may also be e-mailed to: [taxtech@dor.sc.gov](mailto:taxtech@dor.sc.gov).

13. Q. What is the repeal date?

A. The Act is repealed on December 31, 2019. Any credit carry forward of the transferee will continue, however, the transferred credit cannot be used more than 10 years after the credit was first issued to the original angel investor. Code Sections 11-44-80 and 11-44-50(5).

### **PART III: SALE OF AN ANGEL INVESTOR CREDIT ASSET**

Under the Act, an individual investor originally eligible to claim the credit may be required to make South Carolina taxable income adjustments when he sells all or a portion of his equity interest or debt in the qualified business associated with the angel investor credit. The adjustments serve a purpose similar to an income tax credit recapture. Guidance is provided below with respect to certain tax implications upon the sale or transfer of the credit assets. Note: This discussion is limited to the tax consequences in Chapter 44 of Title 11; however, other tax provisions may also apply to a sale or transfer.

1. Q. What are the South Carolina income tax consequences of selling an asset which qualified for the angel investor credit?

A. When an “angel investor taxpayer” (defined in Part III, Questions 2 and 3) sells an asset that qualified for the angel investor credit (“credit asset”) (defined in Part III, Question 4), the investor may be required to make adjustments to South Carolina taxable income. In the event of a net capital gain, the “angel investor taxpayer” will be required to reduce the net capital gain eligible for the South Carolina 44% capital gain deduction under Code Section 12-6-1150 (see Part III, Questions 5 and 6). In the event of a capital loss, the angel investor taxpayer will be required to increase his South Carolina taxable income by the lesser of amount of the angel investor credit or the capital loss (see Part III, Question 7). Code Section 11-44-65.



2. Q. Who is an “angel investor taxpayer?”
- A. An “angel investor taxpayer” is an individual taxpayer who invested in a capital asset and as a result of that investment was eligible to claim the angel investor tax credit. Code Section 11-44-65(A)(1). If the capital asset investment was made by a qualified pass-through entity, the angel investor taxpayer is the individual who is a partner, shareholder, or member that can claim the angel investor credit on his individual income tax return. In the case of a disregarded entity, the angel investor taxpayer is a single member individual of a LLC or the individual grantor of a grantor trust. An angel investor taxpayer is the individual who is originally eligible to claim the angel investor credit.
3. Q. Does an angel investor taxpayer include a taxpayer that receives the angel investor credit through a sale or other transfer?
- A. No. An angel investor taxpayer does not include a taxpayer that receives the credit through a sale or other transfer. The original purchaser of the credit asset continues to be liable for any taxes due under Code Section 11-44-65 even if he has already sold or otherwise transferred the credit.
4. Q. What is a “credit asset?”
- A. A “credit asset” is stock or debt acquired directly by an individual or indirectly by an individual through a pass-through or a disregarded entity who was eligible to claim the angel investor credit with respect to that stock or debt. Code Section 11-44-65(A)(2).
5. Q. What is the 44% capital gain deduction?
- A. Code Section 12-6-1150 provides that individuals are allowed a deduction from South Carolina taxable income of 44% of the net capital gain recognized in this State during the taxable year (“44% deduction”). “Net capital gain” is defined in Internal Revenue Code (IRC) Section 1222(11) as “the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.” In order to qualify for a long-term capital gain, the capital asset must be held for more than one year. IRC Section 1222(3).

6. Q. When is an angel investor taxpayer required to reduce the net capital gain eligible for the 44% deduction?

A. An angel investor taxpayer is required to reduce the net capital gain eligible for the 44% deduction when he recognizes a net capital gain on the sale or exchange of credit assets (defined in Part III, Question 3) in the tax year. The reduction of the net capital gain eligible for the 44% deduction is limited to the income associated with the angel investor credit. The income associated with the angel investor credit is calculated by dividing the total credit amount by 7%. Code Section 11-44-65(B).

If the net capital gain on the sale of a credit asset is **less than** the income associated with the angel investor credit (credit amount / 7%), the net capital gain eligible for the 44% deduction is reduced to zero and there is no 44% deduction. (Example 1).

If the net capital gain on the sale of a credit asset is **more than** the income associated with the angel investor credit (credit amount / 7%), the net capital gain eligible for the 44% deduction is reduced by the amount of the income associated with the angel investor credit. (Example 2).

**Example 1:** Sale of a credit asset which reduces the 44% net capital gain deduction to zero.

Facts: An angel investor taxpayer invests \$30,000 in a qualified business and is eligible to claim an angel investor credit of \$10,500 (35% x \$30,000). After a year, the angel investor taxpayer sells the investment for \$50,000 recognizing a net capital gain of \$20,000 (\$50,000 sales price - \$30,000 basis).

<u>Sales Price</u>	<u>Angel Investment</u>	<u>Gain/Loss</u>	<u>Credit Amount</u>
\$50,000	\$30,000	\$20,000	\$10,500

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

Step 1: Determine the income associated with the angel investor credit.

Credit Amount / 7% = Income Associated with the Credit

\$10,500 / 7% = \$150,000

Step 2: Determine if the net capital gain on the sale of the credit asset is more or less than the income associated with the angel investor credit calculated in Step 1.

\$20,000 (net capital gain) is **less than** \$150,000 (income associated with the credit).

Step 3: Determine the reduction of the net capital gain eligible for the 44% deduction.

Since the net capital gain on the sale of the credit asset is less than the income associated with the original credit amount, the net capital gain eligible for the 44% deduction is reduced by the entire \$20,000 net capital gain. As a result, none of the gain is eligible for the 44% deduction.

**Example 2: Sale of a credit asset which partially reduces the 44% net capital gain deduction.**

Facts: An angel investor taxpayer invests \$30,000 in a qualified business and earns a credit of \$10,500 (35% X \$30,000). After a year, the angel investor taxpayer sells the investment for \$210,000 recognizing a net capital gain of \$180,000 (\$210,000 sales price - \$30,000 basis).

<u>Sales Price</u>	<u>Angel Investment</u>	<u>Gain/Loss</u>	<u>Credit Amount</u>
\$210,000	\$30,000	\$180,000	\$10,500

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

Step 1: Determine the income associated with the angel investor credit.

Credit Amount / 7% = Income Association with the Credit

$$10,500 / 7\% = \$150,000$$

Step 2: Determine if the net capital gain on the sale of the credit asset is more or less than the income associated with the angel investor credit calculated in Step 1.

\$180,000 (net capital gain) is **more than** \$150,000 (income associated with the credit).

Step 3: Determine the reduction of the net capital gain eligible for the 44% deduction.

Since the net capital gain on the sale of the credit asset is more than the income associated with the original credit amount, the taxpayer must reduce the net capital gain eligible for the 44% deduction by the income associated with the credit amount, in this case, \$150,000.

\$180,000 (net capital gain) - \$150,000 (income associated with the angel investor credit) = \$30,000 (net capital gain that qualifies for the 44% deduction).

**Example 3:** Sale of a credit asset sold at a gain and a non-credit asset sold at a loss.

Facts: An angel investor taxpayer invests \$30,000 in a qualified business and is eligible to claim a credit of \$10,500 (35% X \$30,000). After a year, the angel investor taxpayer sells the investment for \$210,000 recognizing a capital gain of \$180,000 (\$210,000 sales price - \$30,000 basis). The taxpayer also has a capital loss on a non-credit asset of \$160,000. As a result, the angel investor taxpayer has a total net capital gain of \$20,000 (\$180,000 net capital gain on credit asset - \$160,000 capital loss on non-credit asset).

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

Step 1: Determine the income associated with the angel investor credit.

Credit Amount / 7% = Income Association with the Credit

10,500 / 7% = \$150,000

Step 2: Determine if the net capital gain on the sale of the credit asset is more or less than the income associated with the angel investor credit calculated in Step 1.

\$20,000 (net capital gain) is **less than** \$150,000 (income associated with the credit).

Step 3: Determine the reduction of the net capital gain eligible for the 44% deduction.

Since the net capital gain on the sale of the credit asset is less than the income associated with the original credit amount, the net capital gain eligible for the 44% deduction is reduced by the entire \$20,000 net capital gain. As a result, none of the gain is eligible for the 44% deduction.

7. Q. How is the reduction of the net capital gain eligible for 44% deduction computed if multiple credit assets are sold in a single year?
- A. An angel investor taxpayer must attribute the net capital gain on credit assets to each credit asset in the ratio of the long-term capital gain on each credit asset over the total of all long-term gains on credit assets to determine the net capital gain reduction. Code Section 11-44-65(B).

**Example 1:** The sale of multiple credit assets which reduce the net capital gain eligible for the 44% deduction to zero.

Facts: An angel investor taxpayer sells three credit assets he has owned for more than a year. The sales price, angel investment, gain or loss on sale, and credit amount for each asset are:

<u>Asset</u>	<u>Sales Price</u>	<u>Angel Investment</u>	<u>Long-term Gain/(Loss)</u>	<u>Credit Amount</u>
A	\$30,000	\$20,000	\$10,000	\$7,000
B	\$60,000	\$30,000	\$30,000	\$10,500
C	\$20,000	\$40,000	<u>(\$20,000)</u>	\$14,000
		Net long-term gain	<u>\$20,000</u>	

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

Step 1: Determine the income associated with each angel investor credit.

Credit Amount / 7% = Income Association with the Credit

Asset A:  $\$7,000 / 7\% = \$100,000$

Asset B:  $\$10,500 / 7\% = \$150,000$

Asset C:  $\$14,000 / 7\% = \$200,000$

Step 2: Determine the net capital gain attributable to each angel investment.

Asset Gain / Total of Long Term Capital Gains x Net Long Term Gain

Asset A:  $10,000/40,000 \times \$20,000 = \$5,000$

Asset B:  $30,000/40,000 \times \$20,000 = \$15,000$

Asset C: N/A since there was a loss on the sale of Asset C

Step 3: Determine if the net capital gain calculated in Step 2 is more or less than the income associated with the angel investor credit calculated in Step 1.

Asset A: \$5,000 (gain attributable to Asset A) is **less than** \$100,000 (income associated with the credit)

Asset B: \$15,000 (gain attributable to Asset B) is **less than** \$150,000 (income associated with the credit)

Asset C: N/A since no gain was attributable to the sale of Asset C

Step 4: Determine the reduction of the net capital gain eligible for the 44% deduction.

Asset A: Since the net capital gain attributable to Asset A (\$5,000) is less than the income associated with the original credit (\$100,000), the net capital gain that qualifies for the 44% deduction is reduced by the entire \$5,000.

Asset B: Since the net capital gain attributable to Asset B (\$15,000) is less than the income associated with the original credit (\$150,000), the net capital gain that qualifies for the 44% deduction is reduced by the entire \$15,000.

The net capital gain of \$20,000 is reduced by \$5,000 from Asset A and \$15,000 from Asset B. As a result, none of the \$20,000 net capital gain is eligible for the 44% deduction.

**Example 2: Sale of multiple credit assets which partially reduces the 44% net capital gain deduction.**

Facts: An angel investor taxpayer sells three credit assets he has owned for over a year. The sales price, angel investment, gain or loss on sale, and credit amount for each asset are:

Asset	Sales Price	Angel Investment	Long-term Gain/(Loss)	Credit Amount
A	\$180,000	\$20,000	\$160,000	\$ 7,000
B	\$60,000	\$30,000	\$ 30,000	\$10,500
C	\$20,000	\$40,000	<u>(\$20,000)</u>	\$14,000
		Net long-term gain	<u>\$170,000</u>	

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

**Step 1: Determine the income associated with the angel investor credit.**

Credit Amount / 7% = Income Association with the Credit

Asset A:  $\$7,000 / 7\% = \$100,000$

Asset B:  $\$10,500 / 7\% = \$150,000$

Asset C:  $\$14,000 / 7\% = \$200,000$

**Step 2: Determine the net capital gain attributable to each angel investment.**

Gain / Sum of Long Term Capital Gains x Net Long Term Gain

Asset A:  $160,000/190,000 \times \$170,000 = \$143,158$

Asset B:  $30,000/190,000 \times \$170,000 = \$26,842$

Asset C: N/A since there was a loss on the sale of Asset C

**Step 3: Determine if the net capital gain calculated in Step 2 is more or less than the income associated with the angel investor credit calculated in Step 1.**

Asset A: \$143,158 (gain attributable to Asset A) is **more than** \$100,000 (income associated with credit amount)

Asset B: \$26,842 (gain attributable to Asset B) is **less than** \$150,000 (income associated with credit amount)

Asset C: N/A since no gain was attributable to Asset C

Step 4: Determine the reduction of the net capital gain eligible for the 44% deduction.

Asset A: Since the net capital gain attributable to Asset A (\$143,158) is more than the income associated with the credit amount (\$100,000), the gain that qualifies for the 44% deduction must be reduced by the income associated with the credit ( $\$143,158 - \$100,000 = \$43,158$ ). \$43,158 of the net capital gain would qualify for the 44% deduction.

Asset B: Since the net capital gain attributable to Asset B (\$26,842) is less than the income associated with the original credit (\$150,000), none of the \$26,842 net capital gain attributable to Asset B qualifies for the 44% deduction.

Summary: \$170,000 (total net capital gain) - \$100,000 (income associated with credit on Asset A) - \$26,842 (income associated with credit on Asset B, limited to the gain on Asset B) = \$43,158 (net capital gain that qualifies for the 44% deduction).



**Example 3: Sale of multiple credit assets and a long-term capital gain from the sale of a non-credit asset.**

Facts: An angel investor taxpayer sells three credit assets and one non-credit asset he has owned for over a year. The sales price, angel investment, gain or loss on sale, and credit amount for each asset are:

<u>Asset</u>	<u>Sales Price</u>	<u>Angel Investment</u>	<u>Long-term Gain/(Loss)</u>	<u>Credit Amount</u>
A	\$180,000	\$20,000	\$160,000	\$7,000
B	\$60,000	\$30,000	\$ 30,000	\$10,500
C	\$20,000	\$40,000	<u>(\$ 20,000)</u>	\$14,000
			Net long-term gain	<u>\$170,000</u>
			Net long-term capital gain on non-credit asset:	<u>\$50,000</u>
			Total net capital gain:	<u>\$220,000</u>

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

**Step 1: Determine the income associated with the angel investor credit.**

Credit Amount / 7% = Income Association with the Credit

$$\text{Asset A: } \$7,000 / 7\% = \$100,000$$

$$\text{Asset B: } \$10,500 / 7\% = \$150,000$$

$$\text{Asset C: } \$14,000 / 7\% = \$200,000$$

**Step 2: Determine the net capital gain attributable to each angel investment.**

Gain / Sum of Long Term Capital Gains x Net Long Term Gain on Credit Assets

$$\text{Asset A: } 160,000/190,000 \times \$170,000 = \$143,158$$

$$\text{Asset B: } 30,000/190,000 \times \$170,000 = \$26,842$$

Asset C: N/A since there was a loss on the sale of Asset C

Step 3: Determine if the net capital gain calculated in Step 2 is more or less than the income associated with the angel investor credit calculated in Step 1.

Asset A: \$143,158 (gain attributable to Asset A) is **more than** \$100,000 (income associated with credit)

Asset B: \$26,842 (gain attributable to Asset B) is **less than** \$150,000 (income associated with credit)

Asset C: N/A since no gain was attributable to the sales of asset C

Step 4: Determine the reduction of the net capital gain eligible for the 44% deduction.

Asset A: Since the net capital gain attributable to Asset A (\$143,158) is more than the income associated with the credit (\$100,000), the net capital gain that qualifies for the 44% deduction must be reduced by the income associated with the credit ( $\$143,158 - \$100,000 = \$43,158$ ). \$43,158 of the net capital gain would qualify for the 44% deduction.

Asset B: Since the net capital gain attributable to Asset B (\$26,842) is less than the income associated with the original credit (\$150,000), none of the \$26,842 net capital gain attributable to Asset B qualifies for the 44% deduction.

Non-credit Asset: The entire gain \$50,000 gain qualifies for the 44% deduction.

Summary: \$220,000 (total net capital gain) - \$100,000 (income associated with credit on Asset A) - \$26,842 (income associated with credit on Asset B, limited to the gain on Asset B) = \$93,158 (net capital gain that qualifies for the 44% deduction).

**Example 4: Sale of multiple credit assets and a capital loss on the sale of a non-credit asset.**

Facts: An angel investor taxpayer sells three credit assets he has owned for over a year. The sales price, angel investment, gain or loss on sale, and credit amount for each asset are:

<u>Asset</u>	<u>Sales Price</u>	<u>Angel Investment</u>	<u>Long-term Gain/(Loss)</u>	<u>Credit Amount</u>
A	\$180,000	\$20,000	\$160,000	\$7,000
B	\$60,000	\$30,000	\$30,000	\$10,500
C	\$20,000	\$40,000	<u>(\$20,000)</u>	\$14,000
	Net long-term gain		<u>\$170,000</u>	
	Capital loss on a non-credit asset:		<u>(\$160,000)</u>	
	Net long-term capital gain		<u>\$10,000</u>	

The reduction of the net capital gain eligible for the 44% deduction is calculated as follows:

**Step 1: Determine the income associated with the angel investor credit.**

Credit Amount / 7% = Income Association with the Credit

$$\text{Asset A: } \$7,000 / 7\% = \$100,000$$

$$\text{Asset B: } \$10,500 / 7\% = \$150,000$$

$$\text{Asset C: } \$14,000 / 7\% = \$200,000$$

**Step 2: Determine the net capital gain attributable to each angel investment.**

Gain / Sum of Long Term Capital Gains x Net Long Term Gain

$$\text{Asset A: } 160,000/190,000 \times \$170,000 = \$143,158$$

$$\text{Asset B: } 30,000/190,000 \times \$170,000 = \$26,842$$

Asset C: N/A since there was a loss on the sale of Asset C

Step 3: Determine if the net capital gain calculated in Step 2 is more or less than the income associated with the angel investor credit calculated in Step 1.

Asset A: \$143,158 (gain attributable to Asset A) is **more than** \$100,000 (income associated with credit amount)

Asset B: \$26,842 (gain attributable to Asset B) is **less than** \$150,000 (income associated with credit amount)

Asset C: N/A since no gain was attributable to the sales of asset C

Step 4: Determine the reduction of the net capital gain eligible for the 44% deduction.

Asset A: Since the net capital gain attributable to Asset A (\$143,158) is more than the income associated with the credit (\$100,000), the net capital gain that qualifies for the 44% deduction must be reduced by the income associated with the credit ( $\$143,158 - \$100,000 = \$43,158$ ). \$43,158 of the net capital gain would qualify for the 44% deduction.

Asset B: Since the net capital gain attributable to Asset B (\$26,842) is less than the income associated with the original credit (\$150,000), none of the \$26,842 net capital gain attributable to Asset B qualifies for the 44% deduction.

Although \$43,158 of net capital gain could qualify for the 44% deduction if there was at least \$43,158 of net capital gain, that amount is limited to the total net capital gain. In this case, since the total net capital gain is only \$10,000, the maximum amount that can qualify for the 44% deduction is \$10,000.

8. Q. Is there a limit on the amount of capital loss on the sale of an angel investment?
- A. Yes. If an angel investor taxpayer recognizes a net capital loss on the sale or exchange of credit assets, the angel investor taxpayer must add to South Carolina taxable income the net capital loss on those credit assets up to the amount of the angel investor tax credit. Net capital loss is defined in IRC Section 1211 without regard to the \$3,000 limitation in IRC Section 1211(b)(1). Code Section 11-44-65(C).

**Example 1: Net capital loss on sale of credit asset is less than the credit amount.**

Facts: An angel investor taxpayer invests \$10,000 in a qualified business and earns a credit of \$3,500 (35% x \$10,000). The angel investor taxpayer sells the credit asset for \$8,000 resulting in a net capital loss of \$2,000 (\$8,000 sales price - \$10,000 basis = \$2,000 capital loss).

Since the net capital loss **is less** than the total amount of the angel investor credit, the angel investor is required to add the entire net capital loss of \$2,000 to South Carolina taxable income.

**Example 2: Net capital loss on sale of credit asset is greater than the credit amount.**

Facts: An angel investor taxpayer invests \$10,000 in a qualified business and earns a credit of \$3,500 (35% x \$10,000). The angel investor taxpayer sells the credit asset for \$5,000 resulting in a net capital loss of \$5,000 (\$5,000 sales price - \$10,000 basis = \$5,000 capital loss).

Since the net capital loss **is more** than the total amount of the angel investor credit, the angel investor taxpayer is required to add the entire amount of the angel investor credit of \$3,500 to South Carolina taxable income.

**Example 3: Capital loss and gain on the sale of credit assets resulting in a net capital loss.**

Facts: An angel investor taxpayer invests \$10,000 in a qualified business and earns a credit of \$3,500 (35% x \$10,000). The angel investor taxpayer sells the credit asset for \$5,000 resulting in a net capital loss of \$5,000 (\$5,000 sales price - \$10,000 basis = \$5,000 capital loss). In addition to the capital loss on credit assets, the angel investor taxpayer had a capital gain on the sale of a credit asset of \$2,000 resulting in a net capital loss for all credit assets of \$3,000 (\$5,000 capital loss on credit assets + \$2,000 capital gain on credit assets).

Since the net capital loss (\$3,000) is **less than** the total amount of the angel investor credit (\$3,500), the angel investor is required to add the capital loss of \$3,000 to South Carolina taxable income.

9. Q. If the angel investor taxpayer sells his angel investor credit, is he still required to reduce his 44% deduction or add to South Carolina income a result of a capital loss as provided in Code Section 11-44-65?
- A. Yes. Even if the angel investor taxpayer sells his angel investor credit, when the taxpayer sells his credit assets, he must still reduce his 44% net capital gain deduction or add to South Carolina taxable income as a result of a capital loss as provided in Code Section 11-44-65.

The transferee of the credit is not liable for the reduction to the 44% deduction or the capital loss add-back.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Rick Reames III  
Rick Reames III, Director

October 9, 2014  
Columbia, South Carolina