

MINNESOTA'S  
ANGEL  
TAX  
CREDIT

---

SMALL  
CORPORATE  
OFFERING  
REGISTRATION  
(SCOR)

A "Short Form"  
Registration Statement

**A Collaborative Effort**

---

Minnesota Department  
of Employment and  
Economic Development



## **MINNESOTA'S ANGEL TAX CREDIT**

### **SMALL CORPORATE OFFERING REGISTRATION (SCOR)**

#### **A "Short Form" Registration Statement**

is available without charge from the Minnesota Department of Employment and Economic Development, Small Business Assistance Office, 1st National Bank Building, 332 Minnesota Street, Suite E200, St. Paul, MN 55101-1351, telephone: (651) 556-8425 or (800) 310-8323, email: [deed.mnsbao@state.mn.us](mailto:deed.mnsbao@state.mn.us); or from Larkin Hoffman Daly & Lindgren Ltd., 1500 Wells Fargo Plaza, 7900 Xerxes Avenue South, Minneapolis, MN 55431, telephone: (952) 835-3800, email: [info@larkinhoffman.com](mailto:info@larkinhoffman.com).

**MINNESOTA'S  
ANGEL  
TAX  
CREDIT**

---

**SMALL  
CORPORATE  
OFFERING  
REGISTRATION  
(SCOR)**

**A "Short Form"  
Registration Statement**

**January 2011**

**A Collaborative Effort** 

---

  
**Minnesota Department of Employment and Economic Development  
Larkin Hoffman Daly & Lindgren Ltd.**

Copyright © 2011 Minnesota Department of Employment and Economic  
Development, Larkin Hoffman Daly & Lindgren Ltd.

ISBN 1-888-404-54-X

## PREFACE

---

Minnesota's Angel Tax Credit, which first became available in 2010, helps Minnesota businesses raise funding by giving their investors a refundable income tax credit equal to 25% of their equity investment. Not all businesses, investors and investments are eligible. Businesses and investors must meet certain requirements and must comply with requirements which are on-going after investment. Part 1 of this booklet lays out eligibility requirements, how the credit works, and other information about the credit.

Businesses seeking funding from investors must comply with numerous requirements and limitations related to sales of their securities. These requirements are particularly difficult for small and early stage businesses. The Small Corporate Offering Registration ("SCOR") helps many businesses raise capital by dramatically easing restrictions on public solicitation, removing limits on the number of investors and otherwise. Part 2 of this booklet explains how SCOR works, what businesses are eligible and when SCOR may be appropriate to use.

This booklet was prepared by the law firm of Larkin Hoffman Daly & Lindgren Ltd. Michael W. Schley, a shareholder at Larkin Hoffman, was the primary author. This booklet is an introduction to the matters discussed and is not intended to be, and should not be relied upon as, legal advice. Like all publications of this kind, this guide is not a substitute for the advice of your attorney on the complexities of the law.

# MINNESOTA'S ANGEL TAX CREDIT



# TABLE OF CONTENTS

---

Chapter 1	<u><i>Key Definitions</i></u> .....	A-5
Chapter 2	<u><i>How The Credit Works</i></u> – General information and key elements of the credit.....	A-7
Chapter 3	<u><i>Qualified Small Businesses (“QSBs”)</i></u> – What businesses are eligible to receive credit-generating investments from investors.....	A-11
Chapter 4	<u><i>Qualified Investors (“Angels”)</i></u> – Which persons are eligible to receive credits for their direct investments.....	A-21
Chapter 5	<u><i>Qualified Funds</i></u> – Certain entities which may make investments to generate credits for the owners of the entity.....	A-23
Chapter 6	<u><i>Qualified Investments</i></u> – What types of investments qualify for credits.....	A-27
Chapter 7	<u><i>Allocations And Timetable</i></u> – The process that takes place after certifications have been obtained which allocates credits to Taxpayers based on particular Qualified Investments by Angels and Qualified Funds.....	A-33
Chapter 8	<u><i>Reporting</i></u> – Obligations after credit-generating investment transactions have been completed.....	A-35
Chapter 9	<u><i>Post-Investment Requirements: Revocation and Repayment</i></u> – What occurs if the business or the investor fails to meet various ongoing requirements.....	A-37
Appendix A	<u><i>Disqualification Provisions</i></u> .....	A-41





## INTRODUCTION

---

Minnesota has a long tradition of supporting the growth of early stage businesses. Today's economy requires us, now more than ever, to provide business owners with the resources necessary to grow their businesses. One way to help businesses grow is to facilitate equity investments. This has become difficult over the last decade as early stage equity capital has become harder to find.

Minnesota's *Small Business Investment Tax Credit* (the "*Angel Credit*"), codified at Minn. Stat. § 116J.8737, is intended to encourage equity investment in early stage, technology-based businesses and encourage job creation by providing tax incentives to investors making investments in these innovative companies either directly or as owners of a "pass-through entity" which makes such an investment. The credit encourages investment in start-up companies that are focused on developing high technology or using new proprietary technology. Obtaining this credit and putting it to good use requires meeting numerous requirements, many of which are not intuitive. This booklet is designed to provide businesses and investors with a basic understanding of how the *Angel Credit* works.

*Angel Credits* represent a dollar-for-dollar reduction of a taxpayer's tax liability. More than twenty states have established programs similar to the one created by Minnesota. The structure and operation of each program differs depending on the particular laws of each state. These programs are generally structured as either refundable or nonrefundable credits. Refundable tax credits (such as Minnesota's) are not limited by the amount of an individual's tax

liability. These programs provide that the state will refund to the taxpayer the portion of investment that exceeds his or her state tax liability. Nonrefundable tax credits, on the other hand, are limited by the amount of an individual's tax liability. Unlike Minnesota's *Angel Credit*, unused credits may be either lost or carried forward to offset future tax liability.

The Minnesota Legislature has appropriated \$11 million in funding for *Angel Credits* for 2010 and \$12 million for each of years 2011 to 2014. Minnesota will stop offering *Angel Credits* after 2014 or when all funding has been used, whichever is sooner, unless the Legislature extends it and appropriates additional funding.

The information provided in this booklet is not intended as, and should not be relied upon as, legal advice. Individuals and business entities should always seek the advice of qualified legal counsel in all matters relating to obtaining and using the *Angel Credit*.

## Chapter 1 KEY DEFINITIONS

---

- *Angel Credit:* A tax credit issued to a *Taxpayer* for making *Qualified Investments*. The investments may be made directly by the *Taxpayer* as an *Angel* or by a *Qualified Fund* in which the *Taxpayer* is an equity owner.
- *Taxpayer:* A natural person who is an *Angel*, an equity investor in a *Qualified Fund* or the beneficiary of a revocable trust (but not the beneficiary of an irrevocable trust).
- *Angel or Qualified Investor:* A natural person who has been certified (or, in certain circumstances, will be certified) as eligible to make *Qualified Investments*. The terms *Angel* and *Qualified Investor* have the same meaning. All *Angels* are also *Taxpayers*.
- *Qualified Fund:* A *Pass-Through Entity* which has been certified as eligible to make *Qualified Investments*. *Qualified Funds* are not *Taxpayers* but their equity holders are.
- *Pass-Through Entity:* An entity which is generally not subject to income tax but as to which any taxable income is taxable directly to its equity owners. These generally include a corporation that has elected to be treated as an S corporation, a general partnership, a limited partnership, an irrevocable trust, or a limited liability company that has elected to be treated as a partnership. Revocable trusts are not *Pass-Through Entities*.

- *Qualified Small Business or QSB:* A small business meeting numerous requirements that has been certified as eligible to receive *Qualified Investments* from *Angels* and *Qualified Funds*.
- *Qualified Investment:* An investment in a *QSB* for equity or for certain types of convertible debt. The investment must meet several requirements.
- *Unitary Group:* Two or more entities which are required under the Minnesota tax laws to file a combined tax return based upon common ownership, operation or activities, or otherwise. Generally, related entities which are required to file consolidated tax returns are treated as a *Unitary Group*. Parent entities, subsidiary entities and “sister” entities are usually included.
- *DEED:* Minnesota’s Department of Employment and Economic Development. *DEED*’s website regarding the *Angel Credit* is [www.positivelyminnesota.com/angelcredit](http://www.positivelyminnesota.com/angelcredit).

## Chapter 2 HOW THE CREDIT WORKS

---

Minnesota's *Angel Credit* is a refundable tax credit equal to 25 percent of each *Qualified Investment*. *Qualified Investments* may be made directly by *Qualified Investors* or *Angels*. *Qualified Investments* may also be made by certain entities which are referred to as *Qualified Funds*. *Angel Credits* related to investments by *Qualified Funds* are issued directly to each equity owner of the fund based upon his or her relative equity interest in the fund.

*Qualified Investments* may be made only in a *Qualified Small Business* or *QSB*. Small businesses must meet numerous requirements in order to qualify for certification as a *QSB*. The primary requirement is that the business is engaged or committed to engage in innovation in certain high-technology fields or six other specifically-identified fields. The business must also meet requirements regarding location of its employees, regarding the business's history and prior funding, and several other matters.

*Angel Credits* are available only for equity investments and for debts which are subject to automatic conversion into equity within three years of issuance without any further action by, or consent from, the *Angel* or *Qualified Fund*. *Taxpayers* may not transfer the credits to other persons required to pay Minnesota taxes.

*Angels* receiving the credit directly and persons receiving the credit as equity owners of a *Qualified Fund* are referred to as *Taxpayers*. The credits are applied against and reduce the Taxpayer's Minnesota income tax liability. The Taxpayer will receive a refund from the

State of Minnesota equal to the amount by which his or her credit exceeds his or her Minnesota income tax liability.

*Taxpayers* need not be Minnesota residents but the *QSBs* in which they invest must be based in Minnesota. The refundable nature of the credit encourages out-of-state investors to invest in Minnesota businesses.

Each *Taxpayer* is eligible to claim up to \$125,000 of *Angel Credits* each year (this relates to \$500,000 of investment). *Taxpayers* filing joint tax returns are eligible to claim up to \$250,000 of *Angel Credits* each year (this relates to \$1 million of investment). Credits allocated to *Taxpayers* related to investments by *Qualified Funds* in which they are owners are included in calculating these annual maximums. *Taxpayers* are not subject to any lifetime maximum of *Angel Credits*.

*QSBs* are not subject to any annual maximum of *Angel Credits* generated. They are, however, subject to a lifetime maximum of generating \$1 million of credits (equal to receiving a lifetime maximum of \$4 million of *Qualified Investments*).

*Angel Credits* are subject to recapture. The investments which generate credits must be held for a three-year holding period. This is computed as the remainder of the calendar year in which the investment is made plus the following two calendar years. Failure to satisfy this requirement will result in the credits being revoked. If the credits are revoked, each *Taxpayer* must file an amended Minnesota tax return for the year in which the credit was issued and the credit must be repaid by the *Taxpayer* within 30 days of revocation.

*QSBs* must continue to meet certain requirements for five years following each investment which generates *Angel Credits*. Failure to comply with certain of these requirements will require the *QSB* to amend its Minnesota tax return within 30 days of a disqualifying event and pay a tax equal to all or a portion of *Angel Credits* allocated

to its investors. The amount of tax is 100% of credits during the year of investment and the next calendar year, then is reduced by 20% each calendar year. Failure by the *QSB* to meet these requirements does not affect or require recapture of credits from the *Taxpayer*.

*Angels, Qualified Funds, QSBs* and the investments generating the *Angel Credit* must all meet certain requirements and certifications must be obtained prior to the investments being completed (with the exception that certain *Angels* may obtain certification post-transaction). Applications for certification are submitted to *DEED*. The certification process entails submitting an application form along with a fee. Certifications will be granted or denied based on whether specific certification criteria and requirements are met. *DEED* will periodically publish on its website a list of *Angels, Qualified Funds, and QSBs* that have been certified. The list will only identify such persons/entities by name and will provide no contact or other information.

The *Angel Credits* are allocated by *DEED* to specific transactions. Requests for allocation of credits must be filed and approved by *DEED* prior to completion of a *Qualified Investment*. No fee is required in connection with such requests. Requests may be filed only after *QSB, Angel, and/or Qualified Fund* certifications have been issued. Requests submitted before that date will be treated as though filed on that date. *DEED* must approve or reject each request for allocation within 15 days of receipt. Credits will be allocated in the order that the requests for allocation are filed with *DEED*. All applications filed on the same day are deemed filed simultaneously, and, if applications filed that day exceed remaining available credits, the remaining credits are allocated on a pro-rata basis. *Qualified Investments* must be completed within 60 days of the date *Angel Credits* are allocated. Failure to complete the transaction within this period results in cancellation of the allocation.

Each *Angel* and *Qualified Fund* must promptly notify *DEED* upon completing the *Qualified Investment*. At the end of the year, *DEED* will then issue a credit certificate directly to each *Taxpayer*. The *Taxpayer's* credit certificate will relate to investments directly by the *Taxpayer* as an *Angel* and the *Taxpayer's* proportionate share of investments by *Qualified Funds* in which the *Taxpayer* is an owner. The credit certificates will be filed with the *Taxpayer's* Minnesota tax return together with a Form M-1B "Business and Investment Credits."

Annual reports to *DEED* are required to demonstrate that eligibility requirements are being maintained. Failure to maintain certain requirements may result in a loss of the credit, requiring immediate repayment of the credits by the *Taxpayer*, or may result in a tax to the *QSB* equal to some or all of the credit received by its investors.



## Chapter 3 QUALIFIED SMALL BUSINESSES (“QSBs”)

---

A company seeking allocation of *Angel Credits* for its investors must be certified by *DEED* as a *Qualified Small Business*, or *QSB*, prior to receiving the investment for which the credit is sought. Certification must be obtained by submitting an application to *DEED* along with a \$150 application fee. The form of application is available on *DEED*'s website. Certification as a *QSB* only qualifies the company as eligible to engage in credit-generating transactions. It does not mean that any credits have been allocated for investments in the company. The credit allocation process is discussed in Chapter 7, *Allocations and Timetable*.

Within 30 days of receiving an application for certification, *DEED* must grant certification, reject the application or request additional information. If additional information is requested, the application must be certified or rejected by *DEED* within 30 days of receiving the additional information. The application fee is not refundable except that if an application is neither certified nor rejected within 30 days, it is deemed rejected and the fee is to be refunded. Rejected applicants may reapply.

Certification is only valid for the calendar year in which the certification was obtained. A new certification is required for each calendar year in which the company proposes to engage in credit-generating transactions.

Several of the company's requirements are ongoing. Failure to maintain compliance may result in a tax on the company up to the amount of credits allocated to its investors but will not result in a tax or recovery of the credit from *Taxpayers*.

In order to receive certification from *DEED* as a *QSB*, a number of conditions must be satisfied.

### **Business Activity**

The company must be "engaged in" or "committed to engage in" "innovation" in Minnesota with at least one of the following categories as its "primary business activity":

- A. Using proprietary technology to add value to a product, process or service;
- B. Researching or developing a proprietary product, process, or service; or
- C. Researching, developing, or producing a new proprietary technology.

Merely engaging in or committing to engage in innovation is not adequate. The innovation activities must be the company's primary business activity. Factors that should be considered in determining a company's primary business activity include not only revenues and funds spent but also other factors such as the company's characterization of itself in other contexts, the portion of the company's income or funding used for the innovative activities, and other factors. The requirement that the company is engaged in innovation is ongoing but a failure to comply with this requirement after credit-generating investments have been made will not result in loss of the credit or require the *QSB* to pay any tax.

Companies whose primary business activities fall within categories A or B must be operating or intending to operate in a qualified “high technology field.” These are identified as the following:

- Aerospace
- Renewable energy
- Environmental engineering
- Cellulosic ethanol
- Materials science technology
- Telecommunications
- Medical devices
- Diagnostics
- Chemistry
- Agricultural processing
- Energy efficiency and conservation
- Food technology
- Information technology
- Nanotechnology
- Biotechnology
- Pharmaceuticals
- Biological
- Veterinary science
- Similar fields

It should be noted that these fields are not defined and, therefore, *DEED* must exercise judgment in reviewing applications for certification. The “similar fields” category is a recognition that technology changes over time.

Entities whose primary business activities fall within category C, above, are eligible if their new proprietary technology is for use in the following fields:

- Agriculture
- Forestry
- Manufacturing
- Mining
- Tourism
- Transportation

Companies engaging in the following types of business are automatically ineligible for certification under categories A and B even if their primary business activities are in a qualified “high technology field.”

- Real estate development
- Insurance
- Banking
- Lending
- Lobbying
- Political consulting
- Information technology consulting
- Professional services provided by attorneys, accountants, business consultants, physicians, and health care consultants
- Wholesale trade
- Retail trade
- Leisure
- Hospitality
- Transportation
- Construction
- Ethanol from corn

This ineligibility does not apply to a company whose primary business activities fall within category C. For example, a company in the transportation industry would be eligible if its primary business activities fall within category C but would be ineligible if its primary business activities fall within category A or category B.

### **Proprietary Technology**

In order for a company to qualify as a *QSB*, its technology must be unique. “Unique” includes, without limitation, innovations that are patented, patent pending, the subject of trade secrets, or copyrighted. Additionally, the technology must be legally owned or licensed by the company. If the technology is used pursuant to a license from a third party, the license need not be exclusive.

## Location of the Company

The company must be headquartered in Minnesota. The jurisdiction of its organization or incorporation is irrelevant (*e.g.*, a corporation formed under Delaware law is not disqualified).

Companies that receive credit-generating investments must maintain their headquarters in Minnesota for at least five years following the year of investment but failure to comply will not result in a tax on the company or recovery of the credit from *Taxpayers*.

The company must meet the following requirements regarding location of its employees:

- 51% of the company's employees must be employed in Minnesota; and
- 51% of the company's payroll must be paid or incurred in Minnesota.

The number of employees deemed employed in Minnesota (and other states) is computed on a "full-time equivalent" basis. For example, two employees, each working 20 hours per week, are considered one full-time equivalent and count as one employee. Similarly, three employees, who collectively work 40 hours per week, also count as one employee.

Where payroll is deemed "paid or incurred" is based upon where employees work without regard to where they reside. Wages paid to an Iowa resident working in Minnesota are deemed paid or incurred in Minnesota. Wages paid to a Minnesota resident working in Wisconsin are deemed paid or incurred in Wisconsin even though subject to Minnesota income tax.

Both of these requirements are ongoing and must continue to be satisfied after the *Qualified Investment* has been made. Failure to do

so may result in a tax on the company up to 100% of the credit but will not result in a tax on or recovery of the credit from *Taxpayers*.

### **History/“Bad Boy”**

The company must have been in operation for fewer than 10 years. The date that operations began is a factual question. The dates that the company was legally formed and that its ownership interests (e.g. stock) were issued are not controlling. Operations are deemed to begin when the company is first considered to be a “development stage company,” as defined in generally accepted accounting principles.

The company must not be subject to any of the disqualifications from eligibility to conduct a Small Corporate Offering Registration pursuant to the Minnesota Securities Act. These disqualifications limit the ability of certain persons and the businesses with which they are associated from conducting a simplified public offering of securities. A copy of these disqualifications is attached as Appendix A. (*Note: Although these disqualifications are patterned after the disqualifications for Regulation A offerings under the federal securities laws, they are not identical.*)

### **Prior Equity Funding**

The amount of private equity raised by the company prior to applying for certification as a *QSB* must be \$2 million or less. This amount is recalculated at the time of each year’s application for certification as a *QSB*. All transactions in prior years are included, including those for which credits were issued, but transactions for which certification is currently being sought are not. *Qualified Investments* received after the date of certification but in the same year as the certification will not affect the company’s status as a *QSB* for the remainder of that year. If the company submits an application for certification in subsequent years, those investments will, however, be included in assessing eligibility.

In determining the amount of equity previously raised, funds received by the company from the sale of debt which is subject to mandatory conversion (*i.e.* automatically or at the election of the company without action by the debt holder) are included. This is true even if the mandatory conversion is subject to contingencies and even if the debt holder has the option to convert such debt into equity prior to the mandatory conversion date.

Funds received from the sale of promissory notes and other debt where the holder has the right to convert such notes or debts into equity of the company but which are not subject to mandatory conversion are not treated as equity. Once such notes are actually converted, such funds will be included as equity previously raised.

*DEED* will determine compliance with the prior funding limitation based upon financial statements submitted by the company in connection with its application for certification as a *QSB*. Financial statements are required of all companies seeking certification. If the company has audited financial statements, they should be submitted. If the company does not have audited financial statements, its application should include a statement to that effect and the company should submit unaudited financial statements. If a company is newly-formed, and has conducted no operations, it should submit a balance sheet as of the most recent practicable date showing equity raised by the company.

## **Employees/Pay Rates**

The company must employ fewer than 25 employees. (*Note:* The company need not employ any employees.) This is calculated on a “full-time equivalent” basis in the same manner as determining the location of employment of the company’s employees. All of the company’s employees, including the company’s officers as well as seasonal and short-term/temporary employees, are counted. If the company is a part of a *Unitary Group*, all employees of all members of the *Unitary Group* must be included in this calculation.

All of the company's employees must be paid at a rate at least equal to 175 percent of the federal poverty guideline for a family of four. This is determined on an employee-by-employee basis, not an average basis. This guideline is published by the Federal Department of Health and Human Services and is generally updated annually. The *DEED* website will be updated whenever this guideline is changed. Once certified as a *QSB*, a company's eligibility will not be affected by changes in this guideline or changes in its rate of pay during the remainder of the year for which certification was granted. As of October 31, 2010, this rate is \$38,588 per year, which equates to an hourly wage rate of \$18.55. For purposes of this calculation, a company may include not only wages and salary paid to the employee but also other benefits deductible by the company and specifically allocable to the employee. For example, contributions to a 401(k) plan and daycare expenses may be included. Benefits such as medical insurance where the cost related to each individual employee is not known may not be included.

Payments to an executive, officer, board member, or any employee who owns more than 20 percent of the company are exempt from this minimum rate requirement. Payments to family members of such persons are not, however, exempt. This requirement applies only to the company seeking to be a *QSB*, not other entities that are part of a *Unitary Group*. It is an ongoing requirement but failure to comply with it will not result in the company incurring a tax or penalty.

There is no requirement of a minimum rate of pay to independent contractors that provide services to the company such as payroll services, computer services, and the like. Companies are cautioned, however, that payments to such services are exempt from this requirement only if the recipients are, in fact, independent contractors. The determination whether a recipient of payments is, in fact, an independent contractor is complicated. The courts, in assessing this issue in cases involving failure to withhold payroll taxes, rely upon numerous factors. Claims that individuals who



are paid at an hourly rate less than the guideline (*i.e.* \$18.55 per hour at October 31, 2010) will likely be suspect. Entities are urged to seek competent advice from their attorneys or accountants as to this determination.

Please remember that certification only qualifies a *QSB* to receive *Qualified Investments*. It does not mean that any *Angel Credits* have been allocated.



## Chapter 4 QUALIFIED INVESTORS ("ANGELS")

---

In order for a natural person to be eligible to receive *Angel Credits* for *Qualified Investments* directly in *QSBs*, he or she must be certified by *DEED* as a *Qualified Investor* (i.e. as an *Angel*). Certification is obtained by submitting an application to *DEED* along with a \$350 application fee. This form of application is available on *DEED's* website.

Certification as an *Angel* must be obtained prior to making the investment for which the credit is sought, with one exception. An *Angel* who is not an accredited investor under the federal securities laws may file his or her application for certification and pay the required fee before allocation of credits or may elect to make such filing within 30 days after completing the *Qualified Investment*.

Within 30 days of receiving an application for certification, *DEED* must grant certification, reject the application or request additional information. If additional information is requested, the application must be certified or rejected by *DEED* within 30 days of receiving the additional information. The application fee is not refundable except that if an application is neither certified nor rejected within 30 days, it is deemed rejected and the fee is to be refunded. Rejected applicants may reapply.

Certification as an *Angel* is only valid for the calendar year in which the certification is obtained. A new certification is required for each calendar year in which the *Angel* proposes to make *Qualified Investments*. Certification as an *Angel* only qualifies an investor as eligible to make *Qualified Investments*. It does not mean that

any credits have been allocated for his or her investments. The credit allocation process is discussed in Chapter 7, Allocations and Timetable.

In order to be certified as an *Angel*, an investor must meet several requirements at the time the *Qualified Investment* is made. These requirements are not ongoing.

The investor must be a natural person. Corporations, partnerships, limited liability companies and other entities are not eligible to be *Angels* but may be eligible to be *Qualified Funds* (if their owners are natural persons). *Exception:* If a revocable trust makes a *Qualified Investment*, the investment is treated as if made by the trust beneficiary and the trust need not be certified as a *Qualified Fund*.

There is no requirement that investors be residents of Minnesota or that they receive taxable income in Minnesota. In order to receive the *Angel Credit*, however, investors will be required to file a Minnesota tax return for the year of investment even if they would not otherwise be required to do so.

After an investment is made, the *Angel* must continue to hold the investment for the remainder of the year of investment and the following two calendar years.

Please remember that certification only qualifies an *Angel* to make *Qualified Investments*. It does not mean that any *Angel Credits* have been allocated.

## Chapter 5 QUALIFIED FUNDS

---

In addition to investments directly by natural persons (*i.e. Angels*), *Angel Credits* are also available for investments in *QSBs* by *Qualified Funds*. In order for an entity to be a *Qualified Fund* and eligible to make investments for which its owners will receive *Angel Credits*, the entity must be certified by *DEED* as a *Qualified Fund* prior to making such investment. Certification is obtained by submitting an application to *DEED* along with a \$1,000 application fee. This form of application is available on *DEED's* website. Certification as a *Qualified Fund* only qualifies the entity as eligible to make *Qualified Investments*. It does not mean that any credits have been allocated for its investors.

Within 30 days of receiving an application for certification, *DEED* must grant certification, reject the application or request additional information. If additional information is requested, the application must be certified or rejected by *DEED* within 30 days of receiving the additional information. The application fee is not refundable except that if an application is neither certified nor rejected within 30 days, it is deemed rejected and the fee is to be refunded. Rejected applicants may reapply.

Certification as a *Qualified Fund* is only valid for the calendar year in which the certification is obtained. A new certification is required for each calendar year in which the entity proposes to make *Qualified Investments*.

Only a *Pass-Through Entity* is eligible to be a *Qualified Fund*. When a *Qualified Fund* makes a *Qualified Investment*, the credits are not allocated to the fund but, instead, are allocated directly to the *Taxpayers* who are equity holders of the fund.

All of the *Qualified Fund's* owners must be natural persons.

A *Qualified Fund* must have at least three owners, each of whom would be eligible to be an *Angel*. If an owner in an entity would be disqualified from receiving *Angel Credits* for his or her direct investment in a *QSB*, that entity cannot be a *Qualified Fund* as to investments in that *QSB*. The disqualification is *QSB* specific. That entity would be eligible to be a *Qualified Fund* as to investments in unrelated *QSBs*.

*For example:* Assume that John Q. Taxpayer has been certified as a *Qualified Investor*. Also assume that John Q. Taxpayer is an equity owner in Great Investments Minnesota LLC which has been certified as a *Qualified Fund*. If John Q. Taxpayer receives more than half of his gross income from Smart Ideas, LLC, he is disqualified from receiving *Angel Credits* related to his direct investments in Smart Ideas. Additionally, because of this disqualification, none of the owners of Great Investments Minnesota may be allocated *Angel Credits* if Great Investments Minnesota invests in Smart Ideas. If Great Investments Minnesota makes a *Qualified Investment* in a *QSB* other than Smart Ideas, all of its owners, including John Q. Taxpayer, may be allocated credits for that investment.

Despite Great Investments Minnesota's disqualification as to Smart Ideas, its owners, other than John Q. Taxpayer, may still be allocated *Angel Credits* for their investments in Smart Ideas other than through Great Investments Minnesota (*i.e.*, directly as *Angel Investors* or indirectly as owners of another *Qualified Fund*).

The *Qualified Fund* need not be organized under Minnesota law and owners of the fund need not be Minnesota residents.

After the investment is made, the *Fund* must continue to hold the investment for the remainder of the year of investment and the following two calendar years.

Please remember that certification only qualifies a *Qualified Fund* to make *Qualified Investments*. It does not mean that any *Angel Credits* have been allocated. The credit allocation process is discussed in Chapter 7, Allocations and Timetable.





## Chapter 6 QUALIFIED INVESTMENTS

---

In addition to the *Angel*, *Qualified Fund* and *QSB* certification requirements previously discussed, the investment must be a *Qualified Investment*. Certain requirements must be met in order for an investment to be treated as a *Qualified Investment*. These requirements relate to the nature of the security received by the investor, the nature of consideration given by the investor, the minimum size of the investment, the maximum credits that can be allocated for investments in each *QSB*, the maximum credits that may be claimed by each *Taxpayer*, and the required status under Minnesota securities laws of issuances of securities eligible for the credit.

### **Ineligibility for Allocation of Credits**

Even though certified as an *Angel*, an investor may be ineligible to be allocated credits for a particular investment. The *Angel* may not be allocated credits for a proposed investment if the *Angel* receives more than half of his or her gross income from the *QSB*. This includes salaries, wages and other payments to the *Angel* as compensation, such as fees paid to the *Angel* as an independent contractor but does not include amounts not taxable to the *Angel* such as reimbursement of bona fide out-of-pocket expenses. For purposes of this calculation, *DEED* looks only to items includable in the *Angel's* "gross income" as reported on IRS Form 1040.

An *Angel* is also ineligible to be allocated credits if a "family member" of the *Angel* receives more than half of his or her gross income from the *QSB*. In making this determination, the term "family member"

is defined by reference to the Internal Revenue Code and includes the *Angel* and his or her spouse plus their parents, siblings, children and the spouse of any of such persons.

Although eligibility to be allocated credits is limited based upon gross income received from the *QSB*, there is no limitation based upon the *Angel's* ownership interest in the *QSB*.

## **Nature of Securities**

Only investments in equity of a *QSB* are eligible for the credit. Eligible forms of equity include common stock, preferred stock, interests in general partnerships, interests in limited partnerships, membership interests in limited liability companies and membership interests in limited liability partnerships. Status as an eligible form of investment is unaffected by whether the *QSB* is a *Pass-Through Entity*.

Many companies have more than one class of equity securities which classes (sometimes referred to as series) have varying rights as to voting, dividends, liquidation, appointment of directors or managers, approval of certain types of transactions and many more aspects. So long as the securities being issued are equity securities, these differences do not affect eligibility for the credit.

Some promissory notes provide that they are or will become convertible into equity.

Some convertible debt is eligible for the credit. In order to be eligible, debt must be subject to mandatory conversion into equity within three years without any further action or consent by the investor. For example, a promissory note which provides that it will automatically convert into common stock on the third anniversary of its issuance will be eligible for the credit. Some debt is subject to conversion upon satisfaction of defined contingencies. Typical contingencies are receipt by the *QSB* of a minimum amount

of funding, achievement by the *QSB* of financial or operational goals, and similar conditions. If a promissory note or other debt gives the holder the right to convert the note into equity, but conversion is solely at the election of the holder, such debt is not eligible for the credit. This is true whether the right to convert exists immediately upon passage of time or upon the occurrence of one or more contingencies. If a promissory note contains both a mandatory conversion provision and an optional right to convert (whether immediate, deferred or contingent), it is treated as equity so long as the mandatory conversion must occur within three years of issuance.

In addition to the types of securities specifically identified, *DEED* is authorized to consider other forms of investment and, if appropriate, treat them as eligible.

### **Consideration for the Investment**

The *Angel's* or *Qualified Fund's* investment in a *QSB* must be a cash investment. Services rendered to the *QSB* do not qualify nor do assignments of assets, whether tangible (such as real estate and equipment) or intangible (such as patents).

If promissory notes (or other debt) of the *QSB* are converted into equity of the *QSB*, such conversion does not qualify. This limitation applies both where the debt holder has a right to convert the note into equity and where the conversion into equity is negotiated at the time of conversion. (*Note:* Cash paid to a *QSB* to purchase equity is an eligible form of consideration without regard to the source of the cash. If a *QSB* repays a note owed to an *Angel* and the *Angel* immediately uses that cash to purchase equity securities in the *QSB*, this requirement will be satisfied.)

## **Minimum Investment Requirements**

In order for an investment to be treated as a *Qualified Investment*, the amount invested must be above a stated minimum. As to investments by *Angels*, that amount is \$10,000. This requirement applies to each investment in each QSB. Separate investments by an *Angel* of \$5,000 in two QSBs will not be a *Qualified Investment*.

As to investments by *Qualified Funds*, the minimum investment is \$30,000 per QSB. Note that *Qualified Funds* are not required to receive a minimum level of funding from each of their owners. This means that an equity owner of a *Qualified Fund* is eligible to receive his or her proportionate share of credits generated by investments by the fund even if his or her investment in the fund is less than \$10,000.

## **Maximum Qualified Investments and Angel Credits**

The total amount of *Qualified Investments* in each QSB may not exceed \$4 million. This equates to \$1 million of *Angel Credits*. This limitation is a lifetime maximum and there is no annual maximum limitation.

*Caution:* Depending upon the timing of *Qualified Investments* and other investments, a company that is eligible to be a QSB in one year may become ineligible to be a QSB in a later year based upon issuances of equity (both eligible and ineligible for the credit).

The maximum *Angel Credits* a *Taxpayer* may receive in any calendar year is \$125,000 which relates to *Qualified Investments* of \$500,000. The maximum amount of *Qualified Investments* for each *Taxpayer* includes investments directly by the *Taxpayer* and the *Taxpayer's* proportionate share of investments by a *Qualified Fund* for which the *Taxpayer* is allocated credits.

*Taxpayers* who are married and file a joint return may receive up to \$250,000 of credits each year which relates to *Qualified Investments* of \$1 million. This is without regard to who made the investments. The following examples illustrate this limitation. If a husband and wife separately make *Qualified Investments* of \$500,000, each is entitled to \$125,000 of credits which may be claimed without regard to whether they file a joint tax return or separate tax returns. If, instead, one spouse makes *Qualified Investments* of \$1 million, the maximum credit available will depend upon their filing status. If they file a joint return, they can receive \$250,000 of credits. If they file separate returns, the spouse making the investment will receive \$125,000 of credits and the non-investing spouse will not receive any credits.

### **Securities Law Status of *Qualified Investments***

The Minnesota Securities Act requires that all offers and sales of securities must be registered unless such offers and sales are made pursuant to valid exemptions from registration. This requirement is in addition to federal securities registration requirements. The *Angel Credit* is available only if the securities issued to the *Angel* and/or to the *Qualified Fund* are offered and sold pursuant to two specified exemptions from registration or pursuant to a short-form registration. Each is discussed in turn.

The Minnesota Securities Act provides an exemption for sales of securities to “accredited investors,” “institutional investors,” and certain other persons. The term “accredited investor” is defined under the federal Securities Act of 1933, as amended. Although there are several other categories, the most commonly relied-upon categories are natural persons who have a net worth of \$1 million or more (not including their principal residence), individuals with a \$200,000 net income for the past two years and reasonably expected in the current year, married couples with joint net income of \$300,000 in each of the last two years and reasonably expected in the current year, and directors, executive officers (as defined) and

general partners of the company. (Note: The number of persons who qualify as accredited investors was significantly reduced by Congress in the Dodd-Frank Wall Street Reform Act which was enacted in July 2010. Investors previously could include the value of their principal residence in determining net worth but now may not include such value.)

The Minnesota Securities Act also provides an exemption from registration for sales of securities made as part of a “private placement.” This exemption limits the number of investors, prohibits general solicitation, limits commissions, sometimes requires a filing to be made, and is subject to other conditions.

The Minnesota Securities Act provides for a “mini public offering” registered as a Small Corporate Offering Registration (“SCOR”). SCOR does not limit the number of investors and public solicitation of investors is permitted. An issuer may sell up to \$1 million of its securities, subject to certain reductions. Issuers are required to file a “short-form” registration statement which is subject to minimal review, to provide each investor with a simplified offering document and to meet certain other conditions and requirements. SCOR is not available to certain types of issuers nor to issuers engaged in certain types of business. SCOR is subject to “bad boy” provisions identical to those of the *Angel Credit*.

## Chapter 7 ALLOCATIONS AND TIMETABLE

---

After required certifications have been obtained (with one exception), the *QSB* together with an *Angel* and/or a *Qualified Fund* may jointly submit a tax credit request application to *DEED* requesting allocation of *Angel Credits*. (*Exception: An Angel* who is not an accredited investor under the federal securities laws may choose to file his or her application for certification and pay the required fee within 30 days after completing his or her investment.) The form of such request is available on *DEED*'s website. The request for allocation will identify and provide information regarding *Angels* (both certified and uncertified) and/or *Qualified Funds*, the *QSB*, prior issuances of its equity for which *Angel Credits* have been allocated and information about the proposed transaction.

The request for allocation will also identify each *Taxpayer* to whom credits will be issued, both directly as an *Angel* and as an equity owner of a *Qualified Fund*, and information about the *Taxpayer's* prior credits and the related transactions. No fee is required in connection with filing a request for allocation.

*DEED* will review the request for completeness, eligibility, and compliance with the limitations as to the maximum allocation of *Angel Credits*, both as to the *QSB* and each *Taxpayer*. Requests must be approved or rejected by *DEED* within 15 days of receipt. Credits will be allocated in the order that the applications are filed with *DEED*. The dates that required certifications were obtained is irrelevant in determining the amount of credits to be allocated.

All requests for allocation filed on the same day are treated as having been filed simultaneously. If two or more requests are filed on the same day and fewer credits remain unallocated than requested, the available credits will be allocated pro-rata among the requests filed on that day.

Once credits have been allocated, the *Qualified Investment* must be made within 60 days of the date of allocation. The investment must also be made prior to December 31st. If these time limitations are not satisfied, the allocation will be canceled and the credits will become available for reallocation for other investments.

*Angels, Qualified Funds* and *QSBs* can make multiple requests for allocation during each year. Each is reviewed separately as to completeness and each allocation of credits is made based upon the date the request was filed. The determinations of *Angel, Qualified Fund* and *QSB* eligibility are made only at the time of the application for certification and are not reconsidered upon submission of a request for allocation of credits.



## Chapter 8 REPORTING

---

After an investment has been completed, *Angels* and *Qualified Funds* must notify *DEED* of the closing of the investment. An *Angel* or *Qualified Fund* that fails to complete the proposed investment must notify *DEED* within five business days of the expiration of the 60-day investment period. There is no provision for extension of these time periods.

At the end of each year, *DEED* will issue a tax credit certificate to each *Taxpayer* for the total amount of credits allocated to the *Taxpayer*. The *Taxpayer* will receive one certificate relating to all *Qualified Investments* including those made directly by the *Taxpayer* as an *Angel*, those made by a *Qualified Fund* of which the *Taxpayer* is an owner, and those made by a revocable trust of which the *Taxpayer* is the beneficiary. Certificates will not be issued to *Qualified Funds*.

By February 1st of each year, each *QSB* that received a credit-generating investment and each *Angel* and each *Qualified Fund* that made a credit-generating investment during the year must submit an annual report to *DEED* and pay a \$100 filing fee. Failure to file a report will result in a fine of \$500.

*Angels* and *Qualified Funds* must submit a report for the year in which they made a *Qualified Investment* for which credits were issued and for the following two years. The report must certify that the investor (*i.e.* an *Angel* or a *Qualified Fund*) remains invested in the *QSB*.

*QSBs* must submit a report for each year in which they received investments for which credits were issued and for five years thereafter. The reports must certify that the *QSB* continues to satisfy the following requirements:

- The *QSB* has its headquarters in Minnesota;
- At least 51 percent of the *QSB's* employees are employed in Minnesota;
- At least 51 percent of the *QSB's* total payroll is paid or incurred in Minnesota; and
- The *QSB* continues to be engaged in, or remains committed to engage in, innovation in Minnesota as required under the conditions of certification.

A company that ceases all operations and becomes insolvent must file an insolvency report documenting its insolvency. Insolvency of the company does not relieve *Taxpayers* of their obligations to file annual reports.

## Chapter 9 POST-INVESTMENT REQUIREMENTS: REVOCAION AND REPAYMENT

---

### Revocation and Repayment by the Taxpayer

The *Angel Credit* is subject to revocation if the *Angel* or *Qualified Fund* fails to hold the securities until after the end of the second calendar year after their investment. For example, securities acquired on any date in 2011 must be held until at least January 1, 2014.

If the *Angel* or *Qualified Fund* fails to hold the securities for the requisite period of time and no exemption is available, the credits are revoked and must be repaid. The amount required to be repaid is not affected by the period between the investment and the date of revocation. If the credits are revoked for failure to hold for the required period, the *Taxpayer* must file an amended Minnesota tax return for the year of investment and must repay the entire amount of credits received, both within 30 days of the date of revocation. If the securities were purchased by a *Qualified Fund*, the fund must notify its members of the revocation. Such members must file amended tax returns and repay the credit. The fund is not required to file a return or pay any tax or penalty.

Under certain circumstances, revocation is not appropriate. The revocation does not apply in any of the following circumstances:

- The securities become worthless;
- The QSB sells 80 percent or more of its assets;

- The *QSB* is sold; or
- The *QSB*'s common stock begins trading on a public exchange.

## **Tax on the Qualified Small Business**

A *QSB* that receives *Qualified Investments* that result in the issuance of *Angel Credits to Taxpayers* must continue to employ at least 51 percent of its employees in Minnesota. The *QSB* must also continue to pay or incur at least 51 percent of its total payroll in Minnesota. These requirements must be met in the calendar year the *Qualified Investment* was received and for five years thereafter.

If the employee and payroll requirements are not met, the *QSB* must pay a tax equal to a percentage of the *Angel Credits*:

<u>Year after investment</u>	<u>Percentage</u>
Year of investment and first year after investment	100%
Second	80%
Third	60%
Fourth	40%
Fifth	20%
Sixth or later	0%

In addition to the employee and payroll requirements, *QSBs* are required to meet other requirements. They must continue to be engaged in or committed to engage in innovation in Minnesota with their primary business activities within one of the permissible categories. Additionally, they must maintain their headquarters in Minnesota, continue to engage in innovation, and continue to comply with the minimum rate of pay requirements. Failure to

comply with these additional requirements, however, does not result in loss of the credit or require the *QSB* to pay any tax.

Even if the *QSB* fails to comply with its ongoing requirements, the *Angel Credit* received by the *Taxpayer* is not subject to revocation or repayment.



## Appendix A DISQUALIFICATION PROVISIONS

---

### Disqualification Provisions

[Minn. Stat. Chapter 80A.50 sec. 302(b)(3)]

(3) Disqualification. Registration under this section is not available to any of the following issuers:

- (A) an issuer subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934;
- (B) an investment company;
- (C) a development stage company that either has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies or other entity or person;
- (D) an issuer if the issuer or any of its predecessors, officers, directors, governors, partners, ten percent stock or equity holders, promoters, or any selling agents of the securities to be offered, or any officer, director, governor, or partner of the selling agent:
  - (i) has filed a registration statement that is the subject of a currently effective registration stop order entered under a federal or state securities law within five years before the filing of the small corporate offering registration application;

- (ii) has been convicted within five years before the filing of the small corporate offering registration application of a felony or misdemeanor in connection with the offer, purchase, or sale of a security or a felony involving fraud or deceit, including, but not limited to, forgery, embezzlement, obtaining money under false pretenses, larceny, or conspiracy to defraud;
- (iii) is currently subject to a state administrative enforcement order or judgment entered by a state securities administrator or the Securities and Exchange Commission within five years before the filing of the small corporate offering registration application, or is subject to a federal or state administrative enforcement order or judgment in which fraud or deceit, including, but not limited to, making untrue statements of material facts or omitting to state material facts, was found and the order or judgment was entered within five years before the filing of the small corporate offering registration application;
- (iv) is currently subject to an order, judgment, or decree of a court of competent jurisdiction temporarily restraining or enjoining, or is subject to an order, judgment, or decree of a court of competent jurisdiction permanently restraining or enjoining the party from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving the making of a false filing with a state or with the



Securities and Exchange Commission entered within five years before the filing of the small corporate offering registration application; or

- (v) is subject to a state's administrative enforcement order, or judgment that prohibits, denies, or revokes the use of an exemption for registration in connection with the offer, purchase, or sale of securities,
  - (I) except that clauses (i) to (iv) do not apply if the person subject to the disqualification is duly licensed or registered to conduct securities-related business in the state in which the administrative order or judgment was entered against the person or if the dealer employing the party is licensed or registered in this state and the form BD filed in this state discloses the order, conviction, judgment, or decree relating to the person, and
  - (II) except that the disqualification under this subdivision is automatically waived if the state securities administrator or federal agency that created the basis for disqualification determines upon a showing of good cause that it is not necessary under the circumstances to deny the registration.



# **SMALL CORPORATE OFFERING REGISTRATION (SCOR)**

A “Short Form” Registration Statement



## TABLE OF CONTENTS

---

Chapter 1	<i><u>When SCOR Should Be Used</u></i> .....	S-7
Chapter 2	<i><u>Eligible Issuers</u></i> .....	S-11
Chapter 3	<i><u>Amount Eligible to Be Raised</u></i> .....	S-13
Chapter 4	<i><u>Public Solicitation Permitted</u></i> .....	S-15
Chapter 5	<i><u>Number of Investors (Escrow of Proceeds Until Minimum Amount Raised)</u></i> .....	S-17
Chapter 6	<i><u>Filing Requirements</u></i> .....	S-19
Chapter 7	<i><u>Information to Investors</u></i> .....	S-23
Chapter 8	<i><u>Liability to Investors/Civil Enforcement/ Criminal Enforcement</u></i> .....	S-27
Chapter 9	<i><u>Additional Considerations</u></i> .....	S-31



## INTRODUCTION

---

This booklet discusses the Small Corporate Offering Registration, commonly known as “SCOR.”<sup>1</sup> SCOR is a simplified (“short form”) method of registration which allows certain small businesses to offer and sell their securities free from prohibitions on public solicitation of investors and from limitations on the number of investors. This prohibition and this limitation, which are conditions of most exemptions from registration, are often a major roadblock to small business financing.

Both federal and state securities laws require registration of securities<sup>2</sup> before they can be offered or sold to investors. Some offerings must comply with the requirements of more than one state’s laws. (State securities laws are commonly known as “blue sky” laws.) Registration is an expensive process requiring disclosure of detailed and extensive information about the company, its business or planned business, its management, its capitalization, its financial statements, and much more.

There are various exemptions from these registration requirements if certain conditions are met. The requirements of the exemptions

---

<sup>1</sup> SCOR is unrelated to the Small Business Administration’s Service Corps of Retired Executives, commonly known as “SCORE.”

<sup>2</sup> The definition of “securities” is very broad and extends beyond the commonly recognized securities such as stock, debt and interests in limited partnerships and limited liability companies. This booklet does not address the scope of this definition. Businesses are urged to consult counsel before seeking or receiving any sort of equity funding or proceeds of debt from any source other than well-recognized lenders such as banks, governmental agencies, and commercial lenders.

are strictly enforced. A sale of securities which is neither registered nor made pursuant to a valid exemption can lead not only to enforcement action by the applicable agency(ies) but usually gives the investor a right of “rescission.” Rescission means that the investor has the right to be paid back the full amount invested (often with interest) based solely upon failure to register the securities. No fraud need be shown. This rescission right exists whether the failure to register was intentional or was the result of ignorance or misunderstanding.

Officers, directors and other “control persons” of an issuer share responsibility for compliance with these requirements and, very often, are liable for the issuer’s rescission obligations. Usually, such liability is “joint and several,” which means that the investor has a right to recover his entire lost profit from any one of the issuer and the other responsible parties with no obligation to attempt to recover from other responsible parties.

Two of the most common conditions of the exemptions from registration are that (i) there is no public solicitation of investors and (ii) the securities are offered and sold only to a limited number of investors. Both of these can severely limit the funding ability of small business.<sup>3</sup>

- ***Public solicitation is prohibited.*** Whether a particular offering involves “public solicitation” is a complicated question. The existence or non-existence of public solicitation has been the primary issue in many government enforcement actions (both civil and criminal), in many private lawsuits by investors and has been the subject of Supreme Court decisions. The

---

<sup>3</sup> Exemptions also exist based upon the relationship of the investor to the issuer (e.g. “rights offering” where only existing owners are offered the securities), the purpose of the issuance (e.g. securities issued as compensation), the characteristics of the issuer (e.g. non-profit entities), the location of the issuers and investors (e.g. the intrastate offering exemption) and numerous others. These exemptions impose widely varying requirements as to the number of investors (“body count”), the categories of permitted investors (e.g. “accredited investors”), the notice filings required to be made, whether those filings are reviewed and the nature of such review, and other matters.



factors that determine whether public solicitation is involved are beyond the scope of this booklet. Fraud need not be shown for this liability to exist. Issuers and their principals may become liable based solely upon violation of these no-public-solicitation prohibitions. These persons may become liable not only based upon their own actions but also based upon actions by brokers, agents and finders.<sup>4</sup>

- ***The number of investors is limited.*** Most exemptions are conditioned upon a limited number of investors (*i.e.* a “body count,” often 35). Investors with high net worth or high net income (and certain other investors) may be excluded from the applicable body count. Nonetheless, because the number of non-counted investors is unknown at the beginning of the offering, companies typically require each of their investors to invest no less than a minimum amount, often \$25,000 or \$35,000. The interaction of the “no-public-solicitation” limitation with the “body-count” limitation is particularly problematic for entrepreneurs who do not have relationships with a significant number of non-counted investors (*i.e.* persons with high net worth or high net income). These limitations also increase the proportionate risk to less wealthy investors. A \$25,000 investment poses a greater risk to the less-wealthy investor because a higher percentage of his or her total portfolio is concentrated in a single investment.

---

<sup>4</sup> The scope of actions that finders are permitted to perform and the nature and amount of compensation that finders may receive without becoming subject to registration as a broker-dealer (and without the issuer becoming subject to claims for rescission based upon the finder’s unregistered status) are among the most misunderstood limitations of the securities laws. These misunderstandings are held both by issuers and purported finders (as well as many of their lawyers). Issuers should not rely upon assertions by finders as to their permitted activities (no matter how ardently made) but should seek advice from competent legal counsel with experience in this area and who represents the interest of issuer (not the interests of the finder) before using a finder.

This booklet relates to SCOR as it is available for offers and sales in Minnesota. The conditions and requirements of SCOR in other states vary and are not addressed herein.

## **Chapter 1 WHEN SCOR SHOULD BE USED**

---

As discussed elsewhere, there are limitations that affect a company's eligibility for SCOR offerings. Examples are the "bad boy" prohibitions and the "domestic entity" requirements described in Chapter 2, Eligible Issuers. If those conditions are not met, SCOR may not be used.

SCOR is a hybrid type of offering. It has characteristics of a public offering and has characteristics of a private placement in which some key conditions and requirement are eased. It is designed to allow smaller businesses (often early-stage businesses) to have access to capital when more traditional private placements are not feasible. It helps address the funding problems of companies that do not have access to a net work of accredited investors. It also may be appropriate for companies that could raise funding through a private placement but want a broader base of owners.

SCOR is most appropriate for companies:

- Whose officers, directors, managers and control persons do not have access to a significant number of persons eligible or willing to make sizeable investments but who do have access to a significant number of investors willing to make smaller investments, either based upon personal relationships, location of the company, customer loyalty, or other factors. The manner of offering is discussed in Chapter 4, Qualified Investors ("Angels");

- Whose prospective investors are not willing to invest by purchasing “restricted securities”. See Chapter 9, Additional Considerations; and
- Whose prospective investors are not willing to make large enough investments to allow the company to comply with “body-count” limitations. See Chapter 5, Number of Investors (Escrow of Proceeds Until Minimum Amount Raised).

Companies conducting SCOR offerings are required to give their investors thorough and carefully documented and drafted information in order to:

- Allow their investors to make intelligent investment decisions;
- Comply with requirements set forth in the registration statement. See Chapter 7, Information to Investors; and
- Avoid liability under the “antifraud rules”. See Chapter 8, Liability to Investors/Civil Enforcement/Criminal Enforcement.

SCOR may also be appropriate for some companies that would be able to raise the needed amount of capital by complying with the private placement restrictions. Some companies use SCOR to enhance their relationships with persons such as customers. For example, SCOR has often been used by microbreweries, wineries, and locally based businesses who want to offer community members an opportunity to become owners of the company.

Companies considering SCOR offerings, and their officers, directors and similar persons, need to consider the risks of personal liability based upon the sale of securities. (These risks also exist as to provide placements of securities.) Status as a corporation, limited liability company, or similar entity does not provide protection against personal liability of its promoters, officers, directors, management

and similar persons in the same way or to the same extent that such protection is provided as to most corporate obligations and liabilities.

Companies considering a SCOR offering need to recognize that prior sales of its securities (whether as part of a formal private placement or otherwise) may affect its eligibility for SCOR for the amount it is eligible to raise in a SCOR offering and should conduct this assessment early, before incurring significant costs.

The company is required to use an attorney in order to provide a legal opinion to be filed as part of its application. See Chapter 6, Filing Requirements. The company must use a certified public accountant to audit or review its financial statements. See Chapter 7, Information to Investors. Companies should also seek the assistance of attorneys and accountants as to the SCOR offering generally and, when engaging such persons, should consider these persons' experience with SCOR offerings and similar transactions.

Nearly all SCOR offerings are conducted without the engagement of a broker/dealer but many companies (both in SCOR offerings and private placements) use the services of a "finder". Companies should seek competent counsel prior to engaging or using a finder. The activities of a finder may put the company and its control persons at risk of liability based upon the finder's status as an unregistered broker/dealer or based upon the finder's dealings with investors.

The Minnesota Securities Act, including provisions related SCOR, are administered by the securities division of the Minnesota Department of Commerce. Although the staff may be helpful in obtaining information and guidance, a company should not expect the staff's participation in preparation of required documents. In addition to the fact that this is not the role of the staff, the number of staff persons has been reduced over the past several years and such persons are not able to devote significant time to any particular company or transaction.



## Chapter 2 ELIGIBLE ISSUERS

---

Not all businesses are eligible to use SCOR. In order to be eligible, a business must meet all of the following requirements:

- ***Issuer only.*** Only issuers can register securities under SCOR. SCOR cannot be used for registration of securities for resale by shareholders, partners, members, etc.
- ***Not already public.*** The Securities Exchange Act of 1934 requires certain companies to register and to file annual, quarterly and other reports with the SEC. Typical of these forms are Forms 10-K, 10-Q, and 8-K. This obligation usually arises because the business has significant revenues, a significant number of owners, or because it has conducted a registered initial public offering. These companies may not use SCOR.<sup>5</sup>
- ***Rule 504 federal exemption.*** Rule 504, which is part of federal Regulation D, is an exemption from the federal securities registration requirements which allows companies to raise up to \$1 million without registration. Only offerings federally exempt pursuant to Rule 504 are eligible to use SCOR.

---

<sup>5</sup> There are some companies who voluntarily make Exchange Act filings and whose securities are publicly traded even though they are not registered under the Exchange Act. Although this ineligibility provision does not apply to these companies, they are not likely users of SCOR because of other limitations.

- ***Not subject to “bad boy.”*** Some companies are not eligible to use SCOR because they, their predecessors, officers, directors, 10% equity holders, promoters, selling agents or any officer, director, governor or partner of the selling agent have previously been sanctioned for certain activities involving fraud or deceit or violations of federal or state securities laws. This disqualification can be waived by the authority whose actions caused the disqualification. The text of Minnesota’s bad boy limitation is Appendix A.<sup>6</sup>
- ***U.S. company.*** The business must be organized in a U.S. state or territory. It need not be organized under the laws of Minnesota. For example, a Delaware corporation is eligible. Companies organized outside the United States are not eligible.
- ***Not a “blank check” or “blind pool” company.*** Some development stage companies either have no specific business plan or purpose or have indicated that their business plan, after they raise capital, is to identify and merge with another company seeking financing. This allows the other companies to obtain their needed funding more quickly and inexpensively and is often seen as a “back door” way to “go public.” Because of significant problems with these offerings and a high incidence of fraudulent transactions, these offerings are not SCOR-eligible.

---

<sup>6</sup> Although the federal Securities Act contains a similar bad boy prohibition, only state limitations apply to SCOR offerings. The Minnesota list of disqualified persons is very similar to, but not identical to, the federal list.



## Chapter 3 AMOUNT ELIGIBLE TO BE RAISED

---

Because SCOR offerings must be made pursuant to Rule 504 of Regulation D, they are limited to \$1 million (the Rule 504 maximum). Proceeds from multiple rounds of financing may be treated as a single offering (*i.e.* “integrated”) for purposes of computing compliance with this \$1 million limitation. This means that proceeds from some sales of securities prior to the SCOR offering will be deemed integrated with the SCOR offering and will limit the size of the SCOR offering. For example, if a company has previously sold \$250,000 in an offering which is deemed integrated, it may raise only \$750,000 in its SCOR offering.

The integration period is not limited to one year or any other time period but includes all sales factually determined to be part of the same offering. The determination of which sales must be integrated is a complicated, highly fact specific analysis. In order to provide certainty and predictability, Rule 504 provides a “safe harbor.” If an issuer has a six-month “gap” prior to the SCOR offering during which no sales of its securities occur (other than pursuant to two very limited exceptions<sup>7</sup>), the transactions before that gap will be treated as separate offerings, not subject to integration.

Even if not subject to “integration,” some prior sales of securities must be counted against the \$1 million limitation. The limitation

---

<sup>7</sup> One exception relates to offshore sales to non-U.S. residents which are not subject to U.S. laws. The other exception relates to issuances which are not intended for capital-raising but are intended to compensate employees and certain others for service to the business.

is reduced by the proceeds from certain sales of securities within one year before the SCOR offering begins, even if those sales are not subject to integration with the SCOR offering. A company determining the maximum amount it is eligible to raise in a SCOR offering should (i) start with the \$1 million maximum, (ii) deduct the amount of all securities (debt and equity) it has sold since the last 6-month gap in its sales of securities, then (iii) deduct all sales in the 12 months before the offering will start.<sup>8</sup> If this initially computed eligibility is too low, the company should consult with an attorney familiar with SCOR. Upon a more detailed analysis, the company may be able to exclude some of the reductions of (i) and (ii). For this initial analysis, the company should treat all funding, both equity and debt, as the sale of securities except funds borrowed from banks, governmental agencies and commercial lenders such as lenders affiliated with dealers of vehicles, computer equipment and software. Other borrowings may, in fact, not cause a reduction in eligible funding but, for this initial analysis, should be deducted.

Businesses whose financing plans include a possible SCOR offering should seek the advice of counsel familiar with Regulation D as far in advance as possible. By making certain changes in financing plans (particularly by insuring a six-month period with no sales), a business may be able to increase the amount eligible to be sold in a SCOR offering.

---

<sup>8</sup> Sales which fall into both categories (ii) and (iii) need only be deducted once.

## Chapter 4 PUBLIC SOLICITATION PERMITTED

---

Nearly all exemptions from securities registration limit the manner of solicitation of investors. Essentially, they prohibit “public solicitation” of investors. One of the primary benefits of SCOR is that the public solicitation prohibition does not apply. The determination whether “public solicitation” is involved depends upon numerous factors and is an often-litigated question.

Public solicitation includes not only traditional advertising but may also be involved if the company contacts a large number of prospective investors or publicly announces its offering. Even if a only small number of investors is contacted, a public offering may be involved, depending upon the relationship of the company and its principals<sup>9</sup> to the prospective investors. Public solicitation is broadly interpreted and includes direct mailing, door-to-door solicitation, announcements on product labeling, seminars, and other methods of contacting prospective investors.

Rule 504 of Regulation D (pursuant to which SCOR offerings are made) includes a prohibition on public solicitation, but this prohibition does not apply and public solicitation is permitted for state registered offerings. The public solicitation prohibition is not waived if the offering is made pursuant to state exemptions from registration. Minnesota adopted the short-form SCOR registration specifically to make public solicitations available to young businesses.

---

<sup>9</sup> Primarily officers, directors and founding shareholders.

State registration removes the federal prohibition on public solicitation only if the securities are registered in all jurisdictions in which the offering is being made. For example, if a business intends to raise capital in Minnesota and other states, the business can use public solicitation only if it registers its securities both in Minnesota and all of the other states. If the business registers the securities in Minnesota pursuant to SCOR but offers the securities in even one state pursuant to an exemption from that state's registration requirements, the federal prohibition on public solicitation continues to apply. There is one exception to this requirement. Recognizing that not all states require registration of securities, sales in those states do not prevent the use of public solicitation so long as the securities are registered in at least one state and are registered in all states where registration is required.

## **Chapter 5 NUMBER OF INVESTORS (ESCROW OF PROCEEDS UNTIL MINIMUM AMOUNT RAISED)**

---

Like many other exemptions, Rule 504 of Regulation D contains a limitation on the maximum number of investors. Because of this “body count” limitation, investors are typically allowed to invest only if they make a sizeable investment, often \$25,000 or \$35,000 or more. This minimum-investment limitation poses a much greater roadblock for entrepreneurs with less access to “deep pocket” investors. Because SCOR does not have a limitation on the number of investors, companies are free to accept investments without regard to the amount invested by each investor. This makes SCOR particularly useful for companies with a large number of potential investors such as a large base of customers. Elimination of this limitation is one of the primary benefits of SCOR.

SCOR offerings which are not subject to Rule 504’s limitation on public solicitation (see the previous chapter) also are not subject to the “body count” limitations of Rule 504.



## **Chapter 6 FILING REQUIREMENTS**

---

A SCOR registration begins with filing of a registration statement with the Securities Division of the Minnesota Department of Commerce. Only the company can file a registration statement. The registration statement must be submitted on Form U-7 which is published by the North American Securities Administrators Association (“NASAA”). Form U-7 consists of a series of questions seeking information about the company. Form U-7 and its instructions may be downloaded from the North American Securities Administrators Association at [www.nasaa.org](http://www.nasaa.org).

In addition to filing the registration statement with Minnesota, the company must also file a Form D with the Securities and Exchange Commission. The Form D gathers primarily identifying information and information about the exemptions claimed. It does not require filing of the form of disclosure document or a consent to service of process, and does not require a fee. The SEC now accepts filing of Forms D only electronically. In order to make such filings, issuers must obtain identifying numbers (similar to user IDs and passwords) from the SEC. Issuers are cautioned to obtain these numbers in advance so that the Form D can be timely filed.

Businesses that choose to provide information about themselves using Form U-7’s question and answer format are cautioned to carefully consider whether there is information that prospective investors should be told which is not explicitly requested by these questions.

Instead of completing Form U-7 by answering all of its questions, companies may provide the information and complete some or all items by referencing an offering document to be delivered to investors. That document would present information about the business in a manner similar to a more traditional private placement memorandum or prospectus. If all items on Form U-7 are addressed in the offering document, the company need not deliver the Form U-7 to investors. If the company makes disclosure in this manner, it must file with its Form U-7 a cross-reference sheet showing where the information called for by the Form U-7, item-by-item, is included in the offering document. This cross-reference sheet need not be delivered to investors.

As discussed below, in Chapter 8, Liability to Investors/Civil Enforcement/Criminal Enforcement, companies conducting a SCOR offering are subject to the anti-fraud provisions of both the Minnesota Securities Act and federal securities laws.

Here are some of the categories of information that must be provided:

- ***What is being offered.*** The registration statement must set forth what type of securities are being offered, the total amount being offered, and the amount being offered in Minnesota. Typical types of securities are common stock, preferred stock, limited partnership interests, membership interests in limited liability companies, promissory notes, and similar instruments.
- ***Consent to be sued in Minnesota.*** The registration statement must include a consent to service of process. The form of such consent is available at [www.nasaa.com](http://www.nasaa.com). By filing this document, the company agrees that an investor suing the company related to his or her investment may sue the company in Minnesota courts even if the company is not otherwise subject to jurisdiction of the Minnesota courts.



This consent does not affect the jurisdiction of Minnesota courts as to matters other than claims by investors related to their investment. This consent is required so that companies located elsewhere cannot avoid lawsuits brought by Minnesota investors in Minnesota courts by claiming that they are outside Minnesota courts' jurisdiction. This consent must be filed by all companies, including those located in Minnesota.

- ***Other states where offered.*** The registration statement must identify all states in which the company proposes to offer the securities, must identify in which states a registration statement or similar filing has been made, must set forth the status of each such application and, if any state has issued a "stop order" prohibiting the company from proceeding with the offering or has taken any similar action, must disclose that information.
- ***Articles and bylaws.*** The company must file a copy of its articles of incorporation and bylaws (if a corporation), partnership agreement (if a partnership), member control agreement (if a limited liability company), or other similar documents. The copies submitted should be copies of signed documents and should include all amendments. There is not a requirement to file amendments or revisions that are adopted after the SCOR offering is complete.
- ***Specimen certificate.*** The registration statement must include a specimen or form of the securities being registered. This might be, for example, a form of stock certificate, a form of partnership ownership certificate, or a form of promissory note. Many smaller companies, particularly limited partnerships and limited liability companies, do not issue certificates to their owners but, instead, keep track of ownership only by the company's official member register or similar records. SCOR registration does not require

companies to change this practice but if this is the case, the registration statement must say so.

- *Opinion of counsel.* The registration statement must be accompanied by an opinion of counsel addressed to the company as to issuance of the securities. The opinion must state that equity securities, when sold to investors, will be “validly issued, fully paid and non-assessable” or, if debt securities are being issued, that they will be “binding obligations” of the company. Counsel’s opinion does not speak to the accuracy or completeness of the information being provided.

## **Chapter 7 INFORMATION TO INVESTORS**

---

When a company raises capital by offering its securities to investors, it has an obligation to provide the investors with material information about itself so that investors can make an informed investment decision. The company's offering document must be given to each investor prior to sale of the securities to that investor. The company must also file a copy of its offering document with the Department of Commerce and, if it amends that document, must file all amendments. In addition to the items addressed in the previous chapter (and similar items) for which the company can usually provide specific information, the answers to other questions and the company's assessment of what other information should be provided involves judgment as to relevancy, materiality, and importance to investors.

In traditional public offerings registered with the Securities Exchange Commission and made by broker dealers on behalf of issuers, investors are provided extensive and detailed information about the company by means of a prospectus. Preparation of such detailed information is complicated and expensive. In many cases, early-stage companies which are SCOR-eligible do not have as much reliable information as do more mature companies. SCOR and the Form U-7 recognize that this type of detailed disclosure is a significant hindrance to smaller companies raising funds. They also recognize, however, that investors should receive adequate accurate information about the company to enable them to make intelligent

investment decisions.<sup>10</sup> SCOR balances these conflicting factors by prescribing specific categories of information to be disclosed in a question-and-answer format. The company must respond to each question in the Form U-7 even if the answer is stating that the question is “not applicable.”

As to financial statements, generally the company is required to file audited financial statements as of its most recent year end, and unaudited financial statements covering the period since the last year end until a recent month end. Minnesota allows those financial statements to be unaudited if they are “reviewed”<sup>11</sup> by independent certified public accountants. A company may not rely upon this exception and must furnish audited financial statements if it has previously conducted a public offering (registered, SCOR or intrastate), has not previously been required to provide audited financial statements in connection with the sale of its securities, and prior sales of securities have not exceeded \$1 million.<sup>12</sup>

One of the most important and most difficult to draft sections of the offering document is disclosure about the risks to investors. They play a key role both in informing investors and in protecting the company and its management against claims by investors that they were misled. There are some risks that face nearly all small

---

10 A few examples are its business or planned business, its products or proposed products, whether it intends to manufacture products itself, where and to whom it has marketed and intends to market its products, its management, its funding to date, its operating history, its licenses as to matters such as technology, and its ownership. (This list of examples is far from complete.)

11 “Reviewed” refers to a professional standard adopted by the American Institute of Certified Public Accountants. In connection with reviewed financial statements, the accountant provides assistance to the issuer as to preparation of the financial statement but does not perform any testing of the company’s financial records.

12 Note that this \$1 million limitation is not limited to sales made pursuant to SCOR or public offerings, but includes all securities sold by the issuer. If the company has previously raised \$500,000 in private offerings and is now planning to raise additional funds in a SCOR offering, the company will be required to furnish audited financial statements if it files to register more than \$500,000.

and early stage companies.<sup>13</sup> Other risks vary significantly based upon the company's business, management and other factors. Identifying risks can be a challenging task both because of the energy necessary to consider possible events and circumstances and, as importantly, to articulate risks which management, because of its familiarity with the company's business, generally assumes and normally would not need to articulate. After identifying potential risks, drafting risk factors also involves judgment as to which risk factors need to be included. While it is important that material risks be disclosed, there is sometimes a temptation to include every possible risk including, sometimes, risks that face businesses generally or which are clearly not applicable to the company. While risks that may, in fact, face the company should not be excluded, judgment must be exercised because inclusion of remote risks may dilute the disclosure value of real risks.

In assessing disclosures to be made, the following may be helpful:

- The information needs to be the most accurate known to the company.
- The company should clearly explain the reliability of the information.<sup>14</sup>
- Estimates and opinions should be clearly distinguished from factual information.
- The information needs to be thorough without burdening the prospective investor with unnecessary detail.

---

<sup>13</sup> Examples are need for additional funding, lack of management experience, lack of a market for the company's products, patent and license risks, and conflicts of interest between the company and its management. (This list of examples is far from complete.)

<sup>14</sup> For example, the company should identify the source of information that it does not know directly by clearly identifying the source of such information (perhaps by citing industry or governmental studies or reports). It should make clear what information is factual vs. what information represents management's opinions based on experience in the area of business.

- Unless obvious, the company should explain why the information provided is important to its business.

When making choices about disclosures, keep in mind two overriding principles:

- Prospective investors are entitled to adequate and accurate information to allow them to make the best possible decision about whether to invest in the company.
- The company and its management can protect themselves from investors' claims that they were misled or not given full information if the company carefully prepares its offering documents.

In addition to the offering document, the company may provide other documents to prospective investors. These might include letters of introduction, advertisements, handouts, or PowerPoint or similar presentations. Companies are required to file a copy of each of these with the Department of Commerce. This includes not only documents which are hand-delivered, mailed or emailed but also those which are made available on the company's (or another) website.

Prior to beginning a SCOR offering, a company should consider that some or all of its website might be deemed to an offering document and may be required to be filed. Even if the company determines that its website (or portions of its website) would not be deemed to be an offering document, the company should carefully review its website to ensure that it is up to date and consistent with the disclosures the company is making in its offering documents.

## Chapter 8 LIABILITY TO INVESTORS/ CIVIL ENFORCEMENT/ CRIMINAL ENFORCEMENT

---

Liability to investors can arise in two manners. If the securities are not registered and an exemption is not available for their offer and sale, investors have a right of rescission. As discussed earlier, claims for rescission do not require any showing of fraud or bad intent. Failure to comply with the registration requirement is, by itself, the basis for liability. Note that compliance is required under both federal and state law. SCOR offerings are exempt under federal law if they comply with Rule 504 and have been registered under state law.<sup>15</sup>

There may be fraud liability to investors if they were not provided complete and accurate information. These claims arise under the “anti-fraud” provisions of both Minnesota law and federal law. Whether the offering is SCOR registered or is exempt does not affect the determination whether investors were defrauded. Liability exists where the company intentionally or negligently provided inaccurate information or failed to disclose information that was known to it. This liability does not require an intention to defraud investors. All that is required is to show that the inaccurate information was known (or should have been known) to be inaccurate or that the undisclosed information was known

---

<sup>15</sup> Although this booklet discusses only the requirements for SCOR offerings conducted in Minnesota, note that compliance with SCOR may be required in multiple states depending both upon the location of investors and the location of sales activities.

(or should have been known) to be material. Note that investors' claims are usually assessed with the benefit of "20/20 hindsight."

In assessing antifraud liability, the courts (as well as the Department of Commerce and Securities Exchange Commission) understand that companies and management do not have the ability to know and foresee all facts and circumstances. Liability may be avoided if the courts (or agencies) can be persuaded that the disclosure was made in good faith after "due diligence."<sup>16</sup> The accuracy and completeness of information that is provided and the efforts made to make full disclosure are often persuasive as to this issue and can serve a significant role in avoiding liability even when disclosure is imperfect. An offering document that evidences careful preparation also may influence lawyers representing investors to advise their clients (*i.e.* the investors) that the cost of litigation makes litigation inadvisable or may lead the lawyer to decline representation on a contingent fee basis. This would, in turn, increase the investor's risk of proceeding with the litigation and may therefore avoid the litigation.

Although status as a corporation, limited liability company or certain other types of entities generally provides protection against personal liability for the company's officers, directors, and others, this status is irrelevant to the determination of those persons' liability under the anti-fraud provisions. Their liability may arise based upon the role they play in the offering, their status as an officer, director or similar status, or their status as "control person"<sup>17</sup> of the company.

---

16 Liability for failure register is not avoided or mitigated by due diligence.

17 The imposition of liability of persons found to be "control persons" prevents the defendants from avoiding liability that claims they were not officers or directors (or similar titles) of the issuer. Status as a control person is a factual determination not dependent upon such status. Multiple persons may be found to be control persons; sole control is not required.



Individuals may be able to avoid personal liability (even if the company is liable) if they can show their due diligence. The defense that the defendant exercised due diligence is assessed on a defendant-by-defendant basis. One person may be found to have exercised due diligence and thereby be free from liability while another defendant may be found to have been negligent in preparing or assessing disclosures and, therefore, liable. Although the responsibility for preparing disclosure is often split among members of management based upon their management responsibilities (e.g. the chief financial officer usually takes the lead as to financial statements and financing plans), each participant should review the entire disclosure document and assess whether his or her reliance on others is reasonable.

Unfortunately, the costs of defending claims of liability are significant and defendants who may have been able to successfully defend against liability often settle in order to avoid the risk of liability and the cost of litigation. In the end, each participant's action to ensure that the company makes thorough and appropriate disclosure is that person's best defense.

Liabilities are almost always assessed on a "joint and several" basis. This means that a plaintiff can recover his or her loss from any defendant found liable. There is no requirement that liability be imposed based upon percentage of ownership or relative fault. Provisions in the company's articles of incorporation or similar documents excluding directors and officers (or persons playing similar roles) from personal liability are not effective to protect such persons from liability for securities law violations. Additionally, obligations to indemnify have been stated to be against public policy and are, generally, not enforceable as to securities law claims. This is true both as to provisions in articles of incorporation, bylaws and similar documents and as to provisions in contractual agreements.



## Chapter 9 ADDITIONAL CONSIDERATIONS

---

**Resale Status.** Unlike securities purchased in a private placement or exempt offering which are restricted from transfer, securities purchased by investors in a SCOR offering are freely tradable. This status continues indefinitely under federal law except as to securities reacquired by the company or its affiliates. Under Minnesota law, the general rule is that a registration statement must be effective in order for sales (including resales) to take place. Eligibility for resale will continue to exist so long as the company maintains effectiveness of its registration statement with the Minnesota Department of Commerce by filing annual reports. Even if the company fails to maintain effectiveness, investors who are not affiliates of the company will usually be able to resell their securities so long as the number of their transactions is limited. Resale of securities purchased in a SCOR offering need not comply with Rule 144 under the Federal Securities Act because, for federal law purposes, they are free trading.

The company may be able to assist investors as to resale by matching prospective buyers and prospective sellers. The requirements for the company to be able to do so are complex and are not addressed here.

**Merit Standards.** Until a few years ago, registered offerings in Minnesota were required to comply with certain “minimum equity,” “cheap stock” and “lock up” requirements. When Minnesota revised its securities laws in 2006, these requirements were eliminated.

*Minimum Offering Size; Proceeds Escrow.* SCOR offerings should be structured so that funds will be accepted from investors only if a minimum amount of funding is raised. This amount is set forth in the offering document. It would be unfair to the investors to allow the company to accept subscriptions unless this minimum amount is raised. The company should set this minimum at an amount that will let it engage in its planned operations as described in the offering document.

In order to protect investors, investors' funds must initially be deposited in an escrow or impoundment account with a bank. The company may not accept the subscriptions or receive any of the proceeds unless the stated minimum amount offering document is received. While the funds are in that account, the company may not access the funds and its creditors may not seize those funds to enforce judgments against the company. If the company's offering document indicates that it is attempting to raise funding beyond the minimum, escrow/impoundment is not required after the minimum is satisfied.

Printed on Recycled Paper With a  
Minimum of 10% Postconsumer Waste

ISBN 1-888-404-54-X

POSITIVELY  
*Minnesota*  
Department of Employment and Economic Development