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This document was authored by representatives of McKenna Long & Aldridge prior to our combination's launch and continues to be offered to provide our clients with the information they need to do business in an increasingly complex, interconnected and competitive marketplace.

Getting Extra Credit For Taking A Risk

While there has been significant liquidity in the private equity markets during the current investment cycle, there is a concern that early stage companies have not fully participated in the current bull market.

Investing in a new, small business — a start-up — is typically viewed as a very high risk investment. While these investments may offer substantial risk-adjusted returns, for the most part, there is a long road between investment in a start-up and the ultimate payday. This may explain, in part, why investing in early stage companies is not as fashionable as other sectors of private equity where liquidity for exists is more available.

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A recent proposal in Congress is designed to provide incentives for these high risk investments by utilizing tax credits. In January, the Access to Capital for Entrepreneurs Act was introduced by Rep. Earl Pomeroy (North Dakota - D) and Rep. Don Manzullo (Illinois - R). This proposed act would give a 25% tax credit to qualified investors who make equity investments in small businesses. It is hoped that this act would incentivize "Angel" investors (in essence, high-net worth individual investors) to be more aggressive by creating a little payback up front. As currently drafted, this new act would allow for a federal tax credit to off set as much as $500,000 in investments a year. In order get the full amount of this credit an investor would have to split its investment between at least two companies a year.

If passed, this tax credit could be just the right incentive to rejuvenate the level of equity investment in small start-up ventures. Obviously, for institutional investors, the $500,000 tax credit is not a lot. However, this act is focused on incentivizing the traditional Angel investor.

How likely is this act to pass? Under the current budget rules in Congress, such a tax credit would require offsetting proposals to generate additional sources of revenue. At this point, while we see that an opportunity to find additional sources of revenue is unlikely, we note a growing interest in this tax credit package. As usual, we will continue to monitor developments in this area.

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