



ANGEL CAPITAL ASSOCIATION

MEMORANDUM TO THE PRESIDENT-ELECT TRANSITION TEAM

**Subject: JOB CREATION—Suggestions for immediate, mid-range and longer term actions
for maximum impact**
From: Angel Capital Association

The purpose of this memorandum is to recommend steps the incoming Administration can take to encourage job creation and support investment in startup companies. We have divided our recommendations into those steps President-elect Trump and his team can take immediately, within the first 100 days, and within the first year in office.

What is Angel Investing and the Angel Capital Association (ACA)

The Angel Capital Association is the world's largest professional organization of accredited angel investors, who invest individually or through angel groups, accredited on-line platforms and family offices. The association represents over 13,000 members who invest their own money in high growth, early-stage, entrepreneurial companies. There are business angels and angel groups in every state. Last year angel investors wrote \$24 billion in personal checks to an estimated 71,000 new companies, creating more than 270,000 new jobs, and supplying as much as 90% of the equity funding for these cutting-edge firms.

These companies are too risky to qualify for bank loans and too small or too early for venture capitalists (VCs). In fact, angels invest in 15 times more start-up companies each year than do VC firms. And we provide not just capital, but time, expertise, mentorship, and governance—often to first time entrepreneurs who dearly need this help.

More importantly, Federal census data shows that high growth startups create *all* net new jobs in our country. A widely regarded study from the Census Bureau and Ewing Marion Kauffman Foundation found that since 2008 new businesses account for nearly all net new job growth and close to 20% of gross job creation. The report also found that over the past three decades companies less than five-years-old have created on average 1.5 million jobs annually. Attachment A is a chart showing within one year of an angel investment, new companies average over 40 new jobs and some add hundreds.

High-growth early-stage startups are fundamental to our economy. To guarantee strong and sustained growth will require that your Administration focus on key changes to policies which benefit entrepreneurs and their investors.

Immediate Actions

1. Nominate a new Securities and Exchange (SEC) Chair and two new commissioners who understand and support access to capital by small businesses.

The JOBS Act was intended to ease the ability of small and young companies to access capital needed to succeed. Implementation under the Obama SEC via extensive rulemaking, has threatened to do the

opposite. The proposed rulemaking would unnecessarily restrict the number of angels who can invest in new companies, would require reviews of the private financial information of investors, and implement excessively strict regulations that would bar entrepreneurs from soliciting funds for extended periods for relatively minor disclosure mistakes. ACA has written letters and solicited Congressional support to stop these SEC actions (detailed below).

We urge thoughtful consideration of Commission nominees who understand capital markets, the innovation economy, and who are knowledgeable about the essential role angels play in helping young companies create jobs so that a better balance can be struck between capital formation and investor/market protection. We would be glad to work with the Trump Transition Team to identify suitable candidates to fill the two existing vacancies on the SEC and the chair position when Commissioner White steps down in January.

2. Instruct the Securities and Exchange Commission (SEC) to retain the existing income and net worth definitions for Accredited Investors

The Dodd-Frank Act requires the SEC to review the definition every four years. The current definition sets a threshold that is based on high wealth requirements and does not consider financial sophistication - currently an accredited investor must have \$1 million in net worth (not counting their primary residence) or \$200K annual income. The SEC has not yet changed the definition, but is considering a variety of suggestions that could disqualify millions of accredited investors and adversely impact access to capital. The SEC and the General Accounting Office estimated that one suggestion considered by the SEC to raise the threshold to \$2.5 million net worth or \$450,000 annual income would exclude 60% of the current angel community and would particularly hurt young, innovative companies in smaller communities and the Midwest. Crowdfunding has already demonstrated it is not a substitute for maintaining the current base of accredited investors.

We strongly urge the SEC to leave the current income/asset thresholds unchanged. We also urge the SEC to expand the definition of who is considered accredited by allowing investors to become accredited by demonstrating appropriate levels of financial sophistication. Attachment B is our 2014 letter to the SEC asking them to first “do no harm” and keep the current definition as well as consider expanding those who can invest in startups.

3. Instruct the current SEC to allow membership in an angel group or platform to meet investor verification tests

The SEC has proposed new rules that greatly increase the burden on companies looking to raise funds from accredited investors by requiring the companies to verify accreditation when they use “general solicitation.” There should be a safe harbor for investors who are known active angels to ensure these companies can raise capital from accredited investors. ACA appreciates that the SEC and Congress want to safeguard small investors from potential risks. The rules require issuers to “take reasonable steps to verify” that investors are accredited, but the SEC has not provided sufficient clarity on what these reasonable steps should be. The SEC issued a “principles-based approach” for this verification process that also provided four optional “safe harbors” requiring issuers (or a third party) to review private financial information to verify income and net worth. Furthermore, entrepreneurs who fail to adequately verify the incomes or net worth of their investors must offer all investors the right to rescind their investments—a death knell to struggling young firms. Of note, neither Crowdfunding (Title III of the JOBS Act) nor Regulation A (Title IV) require issuer verification of income or net worth.

ACA members have said they are not likely to invest if they must use a cumbersome, expensive verification process to prove they can afford to invest their own money in a new, exciting company. We believe membership in an established angel group that adheres to best practices, offers education courses, has a strict code of conduct, recruits angels that members already know, and affirms through self-certification that its members meet income and net worth thresholds, should be deemed as meeting the regulation D requirements.

Separately, the SEC has issued proposed amendments to Regulation D, Form D which would govern reporting requirements for issuers that use general solicitation. We urge that these proposed rules never become final because the penalty for not filing advanced and ongoing reports is loss of the right to raise equity capital for one year, which would kill most startups.

Actions within the First 100 Days

1. Sign the America's Innovators Act (H.R.4854):

Current law restricts the number of individuals who can invest in an angel or venture fund to a maximum of 99 people. Some angel groups and many online platform syndicates pool their money into a fund, or share investment deals between angel groups around the country. H.R. 4854 would increase the investor threshold to 249 individuals for funds of up to \$10 million. H.R.4854, sponsored by Rep. Patrick McHenry (R-NC), passed the House with overwhelming bi-partisan support with a vote of 388-9. ACA is working to get similar bi-partisan support in the Senate. If the legislation does not move in the lame duck session, we will press for early passage in 2017 and would look forward to working with the new Administration to have this job-creation legislation signed within the first three months. Attachment C is a copy of H.R.4854 and its impact.

2. Sign or help pass the Helping Angels Lead our Startups (HALOS) Act (H.R.4498):

One of the components of the JOBS Act mandated the SEC to allow exempt offerings to use general solicitation as long as all of the people participating in the solicitation event were accredited investors. Decades prior to the JOBS Act and continuing today, thousands of local economic development organizations, universities, incubators, government agencies and research organizations sponsor "demo day" events for entrepreneurs to demonstrate their products and meet potential customers, investors and supporters. This is a nicer version of "Shark Tank."

We believe these demo days should be exempted from the category of general solicitation because they do not involve fraud, are attended by the members of the "startup ecosystem," and because there are no reasonable steps these entrepreneurs can take to verify that everyone at the "demo day" event meets the definition of an accredited investor. Failure to verify means the young company inadvertently violates SEC Rule 506(c) and could be required to return investment money to their investors. To avoid this situation ACA asked Congress to pass legislation (HALOS Act) to exempt these types of demo days from the category of general solicitation. With bi-partisan sponsorship and support, the House passed our bill (H.R. 4498) in April 2016 with a vote of 325-89. The Senate version (S.978) is pending passage. If the Senate fails to act this year, ACA plans to press for early enactment in Congress next year with the hope President-elect Trump will sign this simple fix to the JOBS Act. A copy of the legislation and an explanation of its importance are provided as Attachment D.

Actions within the First Year

1. Retain and improve the tax exemption on gains on investments in qualified small businesses

ACA appreciates that President-elect Trump has emphasized the need for comprehensive reform of the US Tax Code. We support tax reform to free-up capital for investment and economic growth. Under Section 1202 of the 2012 American Taxpayer Relief Act, gains on investments in Qualified Small Business Stock (QSBS) were 100% exempted from federal income taxation. This provision was made permanent by Congress in December 2015. This provision has catalyzed investment in innovative startups, recognizing the inherent risks in these types of companies and the job and economic diversity benefits that come from these investments.

Currently the Section 1202 exemption applies only to investments held for five years or longer in companies that are created as "C" corporations. This limits the impact of Section 1202 and undermines the intent of its passage. ACA is recommending three changes to this provision in the tax code:

- a) Decrease the required holding period from 5 years to two years, since successful new companies often are bought out or go public in less than 5 years
- b) Allow small businesses operating as limited liability corporations (LLCs) to qualify, in addition to corporations currently allowed.
- c) Add a few other technical fixes that would clarify confusion by angels and VCs on when the exemption can be implemented.

ACA would be pleased at the appropriate time to provide draft legislative language to implement these improvements.

2. Promote a differential between capital gains and ordinary income.

Many long-time angel investors point out that angel and VC investments in innovative higher-risk new companies grew when the capital gains tax rate for long-term investments decreased to 15 percent. Re-establishing a lower tax rate to encourage job-creating investment than the rate for ordinary income, even when ordinary income rates are reduced and simplified, would be an important incentive to ramp-up invest in risky, but job creating startups. Again, ACA would be pleased to provide some suggested language for the tax reform legislation being considered by the new Administration.

3. Continue current tax treatment of carried interest for angel and VC funds under \$25 million

Angel groups that pool their individual members' own monies into a fund often do not receive any compensation for the work they do in managing and investing these monies until after one of their successful small firms has an exit that returns more to the angels than the original investment. The carried interest is used to help cover some of the expenses angels incurred in managing the fund. ACA recommends that for smaller investment-type funds that support the innovation economy, the provisions applying to the tax treatment of carried interest remain as is.

Angel investors are proud to be an important resource for the startup companies that have created the large majority of net new jobs in the United States over a 25-year period. Angel-backed firms have been some of the most prolific job creators and innovators in recent times. Google, Facebook, Starbucks, Home Depot, Twitter, are just a few examples. The Angel Capital Association looks forward to working with the new Administration in revitalizing the economic engine that has made America great.