

MP&S TAX ALERT: JOBS ACT EASES SMALL BUSINESS FUNDING, ALLOWS CROWDFUNDING

The Jumpstart Our Business Startups Act of 2012 (JOBS act) is designed to provide capital for small businesses and startups. Under the new law, a qualified business will be able to raise cash without meeting all the usual requirements for initial public offerings (IPOs).

Significantly, the new law permits the use of controversial “crowdfunding” in a limited capacity. As a result, even owners of “mom and pop” stores can seek venture capital.

The JOBS act combines several recent proposals affecting the laws and regulations of the Securities and Exchange Commission (SEC), as well as modifying the Sarbanes-Oxley Act of 2002. Here’s a recap of the main provisions of the JOBS act:

- Effective immediately, a privately owned company with under \$1 billion in revenue can raise up to \$50 million without registering with the SEC. Previously, the limit was only \$5 million. If a company qualifies, it’s exempt from the usual requirement of having to conduct independent audits of internal controls for up to five years.
- The new law allows a qualified business to use crowdfunding to attract cash from investors of all shapes and sizes. (See “Can a business raise significant money using crowdfunding?” below.) Crowdfunding generally has been restricted to artists and business owners who accepted small donations in exchange for items like tote bags and CDs. Typically, the business describes its venture and solicits the funds through a website or online portal. Under the JOBS act, investments are limited to the lesser of \$10,000 or 10% of the income of an investor earning less than \$100,000 per year. The SEC has been granted 270 days to provide regulations on offering company equity through crowdfunding platforms.
- A company can have up to 2,000 shareholders or 500 unaccredited investors without registering with the SEC. Before the new law, the number of shareholders was limited to 500. For this purpose, an “accredited investor” is defined as someone who has a net worth of more than \$1 million (not counting a primary residence), has earnings of at least \$300,000 (\$200,000 for single filers) for the last two years, or is a general partner, director or executive officer of the company. If a company with total assets of more than \$10 million exceeds the shareholder cap, it must then register with the SEC within 120 days.
- The new law removes an SEC ban on using advertisements to attract investors to a nonpublic offering. In the past, it has been difficult for companies to keep communications about a private stock sale under wraps.
- A bank (or bank holding company) doesn’t have to register with the SEC until it reaches total assets of at least \$10 billion and at least 2,000 investors. This is a substantial increase from the prior limit of 500 shareholders. It’s believed that this provision will free up more funds for small business owners to borrow.

The SEC certainly has its work cut out for it under the JOBS act. It will have to rewrite its current rules based on certain deadlines imposed by the new law. If you have questions regarding the JOBS act, please give us a call. We’d be happy to explain how the new law may affect your small business or startup.

Can Your Business Raise Significant Money Using Crowdfunding?

Maybe. But consider the following:

- It's important to develop the best means of crowdfunding. Otherwise, it could result in a drain on your resources and time. If a business uses a funding portal, it may help manage communications with investors.
- Be careful about disclosing privileged information. Investors don't need to know your "secret ingredients," but you must provide the requisite background data so they can do their due diligence.
- Be aware that your financials will be available to the public. Even if you raise less than \$100,000, you still have to provide your income tax returns and have financial statements certified. For up to \$500,000, your financial statements must be reviewed by a public accountant. And for between \$500,000 and \$1 million, you need to provide investors with audited financials.
- Don't try to handle all the details on your own. For instance, it's helpful to have an attorney create a Private Placement Memo disclosing risks to investors.
- Weigh all the costs. When you add up fees for audit fees, legal fees and other expenses, you might end up paying \$10,000 or more before you receive your first dollar back.

Finally, keep in mind that crowdfunding isn't available if you've raised more than \$1 million during the last 12 months. Therefore, it may take awhile before a business will become eligible. Depending on your situation, you might want to investigate other opportunities.

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