ALAN WILSON
ATTORNEY GENERAL

December 11, 2013

The Honorable Mark Hammond
South Carolina Secretary of State
1205 Pendleton St.
Columbia, SC 29201

Dear Mr. Hammond:

By your letter dated August 26, 2013, you have asked for the opinion of this Office regarding the interpretation of a provision of Title 11, Chapter 44 of the South Carolina Code, also known as the High Growth Small Business Job Creation Act. Per your letter you explain:

> On June 14, 2013, Governor Nikki Haley signed the High Growth Small Business Job Creation Act into law. One of the stated purposes of the Act was to "encourage individual angel investors to invest in early stage, high-growth, job-creating businesses," by providing tax credits for investments in qualified businesses. Under § 11-44-30(5) of the Act, a business may register with the Secretary of State as a qualified business only if it has been organized for five years or less at the time of the qualified investment.
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> The question has arisen as to the application of this requirement when a business has survived a merger, and the other party to the merger has been organized for more than five years. More specifically, if a business had initially formed as a limited liability company in 2005, and then, in 2009, merged into a newly created corporation that had the same name, owners and purpose as the limited liability company, would the newly created corporation be able to register as a qualified business? Would the merger into a different corporate entity effectively change the date that the business began operation, or would allowing it to register as a qualified business violate the legislative intent of the Act to help early-stage businesses?

Our response follows.

Law/Analysis

As noted in a recent law review article, current public policy reflects an enthusiasm for startups leading many state and local governments to "make tax credits available to investors in startups[.]" Abraham J.B. Cable, Fending for Themselves: Why Securities Regulations Should Encourage Angel Groups, 13 U. Pa. J. Bus. L. 107, 107 (2010). A beneficiary of the recent trend in pro-startup legislation is the so-called angel investor, an individual or group of individuals, who fund startup companies "before they are ready for venture capital" typically in the range of between $500,000 and $5,000,000. Id.

In keeping with this national pro-startup trend, the State of South Carolina recently passed the High Growth Small Business Job Creation Act ("the Act"), an act which now occupies Title 11, Chapter 44 of the South Carolina Code. 2013 S.C. Acts, 120 Legis. Sess., Act No. 80. According to Section 11-44-20 of the Code, the purpose of the General Assembly in passing the Act is "to support the economic development goals of this State by improving the availability of *early stage* capital for emerging high-growth enterprises in South Carolina." S.C. Code Ann. § 11-44-20 (2013) (emphasis added). The Act further explains the legislative intent is to, "encourage individual angel investors to invest in *early stage*, high-growth, job-creating businesses; enlarge the number of high-quality, high-paying jobs within the State; expand the economy of this State by enlarging its base of wealth-creating businesses; and support businesses seeking to commercialize technology invented in this state's institutions of higher education." S.C. Code Ann. § 11-44-20 (emphasis added). The Act attempts to achieve its stated purpose by offering angel investors[1] a nonrefundable income tax credit of thirty-five percent of its "qualified investment." S.C. Code Ann. § 11-44-40(A) (2013).

As defined in the Act, in particular Section 11-44-30(6), a "qualified investment" is an investment, by an angel investor, "of cash in a qualified business for common or preferred stock or an equity interest or a purchase for cash of subordinated debt in a qualified business." The statute defines a "qualified business" as a registered business that:

> (a) is either a corporation, limited liability company, or a general or limited partnership located in this State and has its headquarters located in this State at the time the investment was made and has maintained these headquarters for the entire time the qualified business benefitted from the tax credit provided for pursuant to this section;

[1] Pursuant to Section 11-44-30(1), an "angel investor" is defined as either (a) a resident or nonresident individual subject to taxes imposed by Chapter 6, Title 12; or (b) a pass-through entity formed for investment purposes, with no business operations, committed capital under management under five million dollars, that is not capitalized with funds raised or pooled through private placement memoranda directed to institutional investors. A venture capital fund or commodity fund with institutional investors or a hedge fund does not qualify as an angel investor. S.C. Code Ann. § 11-44-30 (2013).

(b) *was organized no more than five years before the qualified investment was made*;

(c) employs twenty-five or fewer people in this State at the time it is registered as a qualified business;

(d) has had in any complete fiscal year before registration gross income as determined in accordance with the Internal Revenue Code of two million dollars or less on a consolidated basis;

(e) is primarily engaged in manufacturing, processing, warehousing, wholesaling, software development, information technology services, research and development, or a business providing services set forth in Section 12-6-3360(M)(13), other than those described in subitem (f); and

(f) does not engage substantially in:

(i) retail sales;
(ii) real estate or construction;
(iii) professional services;
(iv) gambling;
(v) natural resource extraction;
(vi) financial brokerage, investment activities, or insurance;
(vii) entertainment, amusement, recreation, or athletic or fitness activity for which an admission or fee is charged.

A business is substantially engaged in one of the activities defined in subitem (f) if its gross revenue from an activity exceeds twenty-five percent of its gross revenues in a fiscal year or it is established pursuant to its articles of incorporation, articles of organization, operating agreement, or similar organizational documents to engage as one of its primary purposes such activity.

S.C. Code Ann. § 11-44-30(5) (emphasis added).

It is with this general understanding of the Act that we now turn to the questions mentioned in your letter: (1) whether an otherwise qualified business, started in 2005, which was then merged into a newly incorporated entity in 2009, with the same name, officers and corporate purpose, is a "qualified business" under Section 11-44-30(5)(b) of the Code and therefore must be registered by your Office so as to allow qualifying "angel investors" to receive a tax credit under the Act; and (2) whether, under these facts, the merger effectively changed the date that the business began operation. Because it is our opinion that: (1) the intent of the legislature in enacting Section 11-40-30(5)(b)'s "organized no more than five years" language was to explain precisely what constitutes an "early stage" business in the context of further defining a "qualifying business" under the Act; and (2) for purposes of the tax credit now at

issue, the 2009 merger did not change the date that the business began operation, we believe the business mentioned in your letter should not be registered as a qualifying business under the Act.

1. Ascertaining Legislative Intent

Answering your question first requires us to determine legislative intent. Specifically, we must determine the intent of the General Assembly in passing the High Growth Small Business Job Creation Act, particularly, Section 11-44-30(5)(b)'s "organized no more than five years" provision.

"The cardinal rule of statutory construction is to ascertain and effectuate the legislative intent whenever possible." Hodges v. Rainey, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). When ascertaining legislative intent, South Carolina's appellate courts have stated, "[w]hat a legislature says in the text of a statute is considered the best evidence of the legislative intent or will" and "courts are bound to give effect to the expressed intent of the legislature." Media General Communications, Inc. v. South Carolina Dept. of Revenue, 388 S.C. 138, 148, 694 S.E.2d 525, 530 (2010); Wade v. State, 348 S.C. 255, 259, 559 S.E.2d 843, 844 (2002). Indeed, "[t]here is no safer nor better rule of interpretation than when language is clear and unambiguous it must be held to mean what it plainly states." Jones v. South Carolina State Highway Dep't, 247 S.C. 132, 137, 146 S.E. 2d 166, 168 (1966).

Initially, we note that South Carolina's appellate courts have yet to address the issue of legislative intent as it relates to either the Act as a whole or the specific provision of Section 11-44-30(5)(b). However, as detailed above, Section 11-44-20 explains that the General Assembly's purpose in passing the Act is "to support the economic development goals of this State by improving the availability of *early stage* capital for emerging high-growth enterprises in South Carolina." S.C. Code Ann. § 11-44-20 (emphasis added). Section 11-44-20 further states the intent in passing the Act is to, "encourage individual angel investors to invest in *early stage*, high-growth, job-creating businesses; enlarge the number of high-quality, high-paying jobs within the State; expand the economy of this State by enlarging its base of wealth-creating businesses; and support businesses seeking to commercialize technology invented in this state's institutions of higher education." S.C. Code Ann. § 11-44-20 (emphasis added).

Moreover, Section 11-44-30(5), when viewed as a whole, is clearly intended to define the requirements of a "qualifying business" under the Act and goes to great lengths in order to do so. For example, Section 11-44-30(5)(a) follows up on the broad language from Section 11-44-20, and defines exactly which entities qualify as an "enterprise" in South Carolina. See e.g. S.C. Code Ann. § 11-44-30(5)(a) (2013) ("[A qualifying business] is either a corporation, limited liability company, or a general or limited partnership located in this State and has its headquarters located in this State at the time the investment was made and has maintained these

headquarters for the entire time the qualified business benefitted from the tax credit provided for pursuant to this section."). Likewise, Section 11-44-30(5)(b), the statute mentioned in your letter, provides additional guidance from the broad language of Section 11-44-20's "early stage" provision stating that a qualifying business must be "*organized no more than five years before the qualified investment was made.*" S.C. Code Ann. § 11-44-30(5)(b) (emphasis added). The same is true with respect to Section 11-44-30(5)(c) and (d), which seek to define the "small business" portion of the Act by requiring that a qualifying business have twenty-five or fewer employees and must have a gross income of two million dollars or less. S.C. Code Ann. § 11-44-30(5)(c); S.C. Code Ann. § 11-44-30(5)(d). Finally, Sections 11-44-30(5)(e) and (f) provide further clarification of Section 11-44-20's "high-growth, job creating businesses" language by explaining exactly which industries qualify for the credit and which industries do not. S.C. Code Ann. § 11-44-30(5)(e); S.C. Code Ann. § 11-44-30(5)(f).

Here, a review of the authority mentioned above leads us to conclude that the legislative intent in passing the High Growth Small Business Job Creation Act is obvious—to stimulate economic growth and development by providing tax credits to individuals and entities meeting the definition of "angel investors" so long as they make "qualifying investments" in "qualifying businesses" as defined by the Act. S.C. Code Ann. § 11-44-20. Additionally, it seems clear that Section 11-44-30(5), when viewed as a whole, is intended to define the requirements of a "qualifying business" under the Act. Furthermore, the legislative intent in enacting Section 11-44-30(5)(b)'s "organized for no more than five years" language is to provide a specific definition of the term "early stage" which is mentioned in the legislative purpose of Section 11-44-20. As such, we believe this provision applies only to otherwise qualifying businesses that are initially organized in the five year period prior to when a qualified investment is made. Accordingly, while we acknowledge that South Carolina's appellate courts have yet to interpret Section 11-44-30(5)(b)'s "organized no more than five years" provision, we believe the language is clear and unambiguous and therefore must be given its plain and ordinary meaning—that a qualifying business must be "organized no more than five years before the qualified investment was made" in order for a qualified angel investor to receive a tax credit under the Act.

2. The Effect of the Merger

Having determined the legislative intent as it relates to Section 11-44-30(5), particularly Section 11-44-30(5)(b)'s "organized no more than five-years" provision, we now move to the other issue contained within your question, whether, under these facts, the merger effectively changed the date that the business began operation. We believe it does not.

The Supreme Court of South Carolina, in Stephenson Finance Co. v. S.C. Tax Comm'n., 242 S.C. 98, 104, 130 S.E.2d 72, 75 (1963), defined a "merger" as an arrangement "by which two or more corporations become united in interest." Going into further detail, the Court said,

"[s]trictly speaking, a merger means the absorption of one corporation by another, which retains its name and corporate identity with the added capital, franchises and powers of the merged corporations." Id. The Court then stated, "[i]t is the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged therein." Id. at 104-05, 130 S.E.2d at 75.

A variety of authorities, including the Internal Revenue Code, classify a merger as a corporate reorganization. 26 U.S.C. § 368(a)(1)(A); Torrey Delivery, Inc., v. Chautaugua Truck Sales and Svc. Inc., 47 A.D.2d 279, 282, 366 N.Y.S.2d 506, 510 (1975) (quoting Business Corporation Law, §§ 901, 902, 905) ("Technically, a merger is a corporate reorganization."); West's Cal. Corp. Code § 181 (explaining a reorganization is a merger); Traverso v. Clear Channel Comm., Inc., 52 Fed. App'x. 878 (9th Cir. 2002) ("Under California law, a merger is a reorganization.") (internal citations omitted); Ill. Dept. of Rev., 2010 WL 4719856, n.1 (Oct. 13, 2010) (stating mergers are a type of reorganization); CRT Svcs., Inc. v. Seven Hanover Assoc., 1992 WL 236198 *6 (S.D.N.Y. 1992) (noting a merger is a corporate reorganization); Celestine J. Richards, The Efficacy of Successorship Clauses in Collective Bargaining Agreements, 79 Geo. L.J. 1549, 1552 (1991) (stating a merger is one type of corporate reorganization). Additionally, Section 33-44-906(a)(1)-(5) of the South Carolina Code, which deals with the legal effect of a merger, appears to imply the same, explaining that while all parties to a merger other than the surviving entity may technically terminate, all property, debts, liabilities, obligations, pending actions, rights, privileges, immunities, powers and purposes of such entities *continue* in the surviving entity.

Here, while it is true the surviving entity from the merger of the business at issue was created in 2009, we believe the authority detailed above suggests that the 2009 merger did not constitute the initial "organization" of the business for purposes of Section 11-44-30(5)(b) of the Code. To the contrary, the 2009 merger was a mere corporate "reorganization" of the business from a South Carolina limited liability company ("LLC") to a Delaware corporation. See e.g. 26 U.S.C. § 368(a)(1)(A); Torrey Delivery, Inc., 47 A.D.2d at 282, 366 N.Y.S.2d at 510; West's Cal. Corp. Code § 181; Ill. Dept. of Rev., 2010 WL 4719856, n.1 (Oct. 13, 2010); CRT Svcs., Inc., 1992 WL 236198 *6 (S.D.N.Y. 1992); Richards, 79 Geo. L.J. at 1552. In other words, the 2009 merger simply constituted a change in the corporate form of the business as opposed to the creation of an entirely new business, at least within the meaning of Section 11-44-30(5)(b)'s "organized no more than five years" provision.

Furthermore, this conclusion is consistent with the requirements from Stephenson Finance Co., and Section 33-44-906(a)(5) of the Code, which explain that the effect of a merger results in the surviving entity retaining the same corporate identity and corporate purpose. Stephenson Finance Co., 242 S.C. at 104, 130 S.E.2d at 75 ("Strictly speaking, a merger means the absorption of one corporation by another, *which retains its name and corporate identity* with

the added capital, franchises and powers of the merged corporations.") (emphasis added); S.C. Code Ann. § 33-44-906(a)(5) (2006) ("[E]xcept as prohibited by other law, all the rights, privileges, immunities, powers, and *purposes* of every limited liability company and other entity that is a party to a merger vest in the surviving entity.") (emphasis added). Indeed, it cannot be argued that an entirely new business was created in 2009 simply because of a change in the corporate form, especially where the legal effect of the merger operated to continue the corporate purpose and the facts suggest that the surviving entity did just that. As noted in your letter, while the corporate form of the business changed in 2009, its name, principal officers, and corporate purpose remained the same. In fact, as you have said, the business' website continues to say it was founded in 2005—the date the South Carolina LLC was formed.[2]

Moreover, were we to interpret a mere change in the corporate form as the organization of an entirely new business, such an interpretation would lead to an absurd result. Statutes must be interpreted with a "sensible construction," and a "literal application of language which leads to absurd consequences should be avoided whenever a reasonable application can be given consistent with the legislative purpose." U.S. v. Rippetoe, 178 F.2d 735, 737 (4th Cir. 1950). In this instance, if we were to opine that a subsequent merger created a newly-organized business for purposes of Section 11-44-30(5)(b), businesses which are not "early stage" businesses under Section 11-44-20, could simply change their corporate form and, if otherwise qualified, reorganize in order to become a qualifying businesses under the Act. The effect of this interpretation would create a windfall for qualifying "angel investors" in that they would receive tax credit for investing in businesses which could not truly be considered "early stage" businesses, but, because of a change in the corporate form, would now constitute a "qualifying business" under the Act. Additionally, expanding the tax credit to reorganized businesses would likely come at the expense of those businesses that truly are "early stage" businesses, as one could argue a more established, but reorganized business may be a safer investment than a true startup company that has only been in existence for five years or less. Accordingly, we believe, at least for purposes of Section 11-44-30(5)(b)'s "organized no more than five years" provision, that a merger, which is a mere reorganization and change in the corporate form, does not change the date that a business began operation.

Conclusion

To summarize, it is the opinion of this Office that: (1) the intent of the General Assembly in enacting Section 11-40-30(5)(b)'s "organized no more than five years" language was to explain precisely what constitutes an "early stage" business in the context of further defining a "qualifying business" under the Act; and (2) for purposes of Section 11-44-30(5)(b), a merger, which we believe operates as a reorganization and mere change in the corporate form, does not

[2] See www.kiyatec.com/news.htm (last visited December 9, 2013) (listing news and events dating back to November 4, 2005).

change the date that a business began operation under the Act. As a result, it is our opinion that the business mentioned in your letter is not a "qualifying business" under the Act and therefore, should not be registered with your Office. That said, we note that because Section 11-44-30(5)(b)'s "organized no more than five years" provision has yet to be interpreted by South Carolina's appellate courts, this issue may be more conclusively resolved by seeking a declaratory judgment or requesting legislative clarification on the matter.

Sincerely,

Brendan McDonald
Assistant Attorney General

REVIEWED AND APPROVED BY:

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