

Reenact Qualified Business Venture Credit 2021 Fact Sheet:

Opportunity

The Qualified Business Venture (QBV) Tax Credit program provided critical capital formation support to emerging, innovation-based small businesses in North Carolina from 1989 to 2013. Today there are greater numbers of startups in North Carolina and due to COVID19 and economic uncertainty the challenges they face when raising capital are even more daunting. Prior to COVID19 there was an increase in equity capital available to private companies but many early stage companies had been left behind by institutional investors who invest in fewer and larger late stage deals. In the current environment this trend has been amplified as institutional investors have reserved funding for their existing portfolio companies putting additional pressure on angel investors to fill the early stage funding gap.

Economic recessions historically result in a decrease in angel investment volume in North Carolina. In the years following the most recent economic recessions, NC angel investing declined by 62% (2001-2003) and 52% (2008-2010) compared to the year prior to the downturns. The COVID19 induced recession has been particularly hard hitting for rural counties in NC and the QBV legislation is an opportunity to stimulate investment statewide.

Moreover, since the sunset provision took effect in 2013, NC businesses have been at a competitive disadvantage versus several neighboring states that have “angel investor” tax credits. South Carolina, in particular, offers a transferrable credit that has attracted North Carolina angel investors.

Recommendation

The existing QBV Tax Credit statute should be reenacted to stimulate early stage investment activity and level the playing field for NC entrepreneurs, with the following updates:

- Increase total cap from \$7.5M to \$10M
- Include a 10% Diversity Bonus for investors that invest in companies located in rural counties (Tier 1 & 2 counties) or opportunity zones. This does not increase the total cap of the program but allows individual investors up to 35% credit.

Background

The QBV Tax Credit provided a 25% credit against personal income tax for individual investments in qualifying small businesses. Credits were capped at \$50,000 per individual investor per year and a \$7.5 million per year cap applied to all investments statewide. Investors could also receive the tax credit if they made their investments in the Qualified Business via a pass-through entity. The entity, such as an angel group, could receive a credit equal to 25% of the investment, with a maximum credit of \$750,000 per year. To qualify for the credit, businesses that receive investments must have less than \$5 million in revenues annually and be engaged primarily in manufacturing, processing, warehousing, wholesaling, or research and development. These early stage businesses are the drivers of home-grown economic growth in our state with above average employee wages and they are at risk due to the current economic climate which makes it even more difficult to raise equity capital.

Furthermore, because most emerging innovation-based companies in North Carolina rely on investments rather than revenues to fund their operations, these companies have not benefited from reductions in North Carolina’s corporate tax rate. Finally, although North Carolina has reduced its personal income tax rate, the rate remains high enough to make the QBV a meaningful incentive to angel investors.

Economic impact

5X Multiplier: Between 1989 and 2013, investors claimed **\$126 million** in QBV Tax Credits. This stimulated over **\$741million** in financing for qualifying small businesses representing a **5.9X multiplier** on State dollars during the life of the program. Moreover, QBV companies went on to raise billions of dollars in follow-on capital creating long-lasting economic impact in North Carolina.

NC Angel Investment Decline: Even before COVID19, the number of angel investments (Exhibit A) was declining in North Carolina and nationally despite an annual increase in new innovation-based company formation. This created a funding void for the earliest innovation-based start-up companies and the situation is likely to continue to worsen in the next year(s).

NC investors choosing to invest outside the State: These problems are compounded due to the fact that after losing the QBV Tax Credit, NC investors more frequently invest out-of-state. They are also incentivized by a transferable credit to invest in South Carolina. May 2020 survey data from the NC Small Business and Technology Development Center (SBTDC) (Exhibit B) demonstrates that: the QBV Tax Credit would result in more capital being invested in earlier and riskier stage companies, with a strong preference to invest in NC companies.

Increase Angel Investor Participation: In the same May 2020 Survey (Exhibit B, C & below), 70% of the 22 angel group leaders say that the QBV credit would have a very strong impact on recruitment and increase angel investor membership in their groups. More investors in these groups leads to more investments in early stage companies in NC.

Elimination of the QBV Tax Credit in 2013 impacted angel investing.
42% of angel groups invest in fewer deals
50% of angel groups invest less capital
50% of angel groups invest in more out-of-state companies
Only 17% of groups reported that their investing activity is the same as before the credit expired

NC SBTDC: Angel Investor Community Survey, May, 2020. N=22 angel groups, 56 individual investor

The companies that would benefit from reenactment of the credit represent the seeds of future economic prosperity and job creation in North Carolina and need the help of policy makers to attract the capital essential for their survival. Reenactment of the QBV Tax credit will help bring angel investors back into early stage capital markets and lessen the impact of COVID19.

For more information on the contents of this Fact Sheet,
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Appendix to QBV Overview

Exhibit A

The number of angel deals is declining – now is the time for investor tax credits

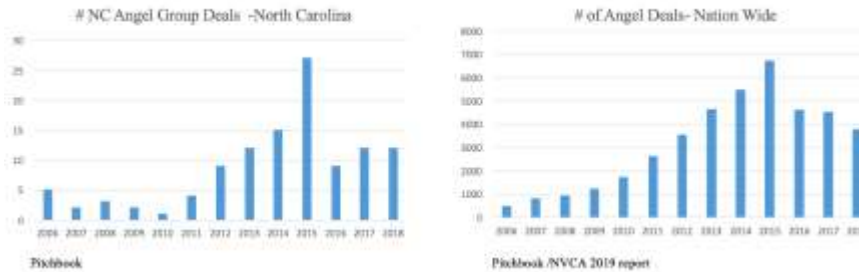


Exhibit B

Reauthorizing the QBV Tax Credit would impact investment decisions on the amount of capital to invest, risk level, and company geography.

What impact would a state tax credit of 25% to your members for investments in NC companies (capped at \$50K per year) have on the amount of capital your group would invest in NC companies?

ANSWER CHOICES	RESPONSES
Very strong impact- Because of the credit, we would be likely to invest at a level that would provide the maximum credit to our members or group	30.43% 7
Modestly strong impact- We would invest more than we do now	56.52% 13
Limited impact- The credit would be nice but it would only be a minor factor in deciding how much to invest	8.70% 2
No impact- We would not consider the credit in making decisions about the amount of capital to invest	4.35% 1
TOTAL	23

What impact would a tax credit have on your member's willingness to invest in earlier-stage deals or those they perceive as higher risk than those your group normally invest in?

ANSWER CHOICES	RESPONSES
Very strong- We would seek out riskier deals	8.70% 2
Modestly strong- We would invest in riskier deals if the opportunity was presented	65.22% 15
Limited- While the credit would help with our overall appetite for angel investing we would not invest in riskier opportunities	17.39% 4
No impact- We would not consider the credit in making investment decisions based on risk	8.70% 2
TOTAL	23

What impact would a state tax credit of 25% to your members for investment in NC companies (capped at \$50K per year) have on your group's willingness to invest in companies outside of NC?

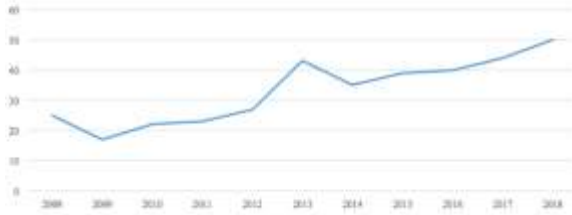
ANSWER CHOICES	RESPONSES
Very strong impact- We would likely only invest in NC companies because of the credit	8.70% 2
Modestly strong impact- This would cause us to have a much stronger preference to NC companies vs. out-of-state companies compared to what we currently have	56.52% 13
Limited impact- We will continue to invest in many out-of-state deals but will consider more NC opportunities.	21.74% 5
No impact- We would not consider the credit in making decisions about the location of companies	13.04% 3
TOTAL	23

NC SBTDC: Angel Investor Community Survey, May, 2020. N=22 angel groups, 56 individual investors

Exhibit C

North Carolina innovation-based company formation has been increasing for over a decade

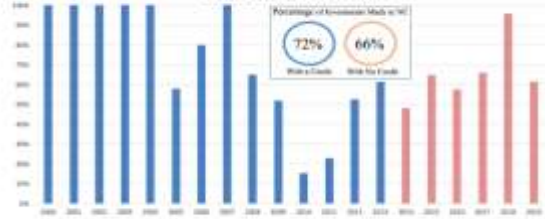
Annual Number of University Startups in NC
2008-2018



Association of University Technology Managers. Includes data from Duke, NCSU, ECU, UNC-CH, UNC, UNCC, UNCW, Wake Forest. Note: 2016-2018 data for Wake Forest were not available; values for these years were extrapolated based on 2009-2017 data.

Angels more frequently invested in NC and less frequently out-of-state when the QBV Tax Credit was authorized

Percentage of Capital Invested in NC Companies by NC Angel Groups
Before & After Tax Credit



Pitchbook. This includes all of the NC angel group data available on Pitchbook (representing 21 groups and 202 deals). Only deals under \$4.5M in value were included in this analysis as larger deals would include larger institutional investor participants.