

## **Qualified Business Venture Founders Credit Fact Sheet**

### **Issue**

North Carolina's economic success in the coming decades will depend in part on our ability to commercialize technologies developed in our university system and other public and private research institutions. Presently a key impediment to such commercialization is the lack of seed and venture capital. Mechanisms for encouraging the availability of capital should be an integral part of our state's economic development program.

### **Recommendation**

**North Carolina should adopt a capital gains tax exclusion for founders' stock and angel investments.** Basing eligibility for such a "founders' credit" on the State's existing Qualified Business Venture Tax Credit would effectively target the proposed incentive to investors in start-up companies with disproportionate potential for rapid growth and high job creation.

### **Advantages**

- Improves availability of start-up capital by encouraging individuals to invest in North Carolina start-up companies.
- Encourages creation of companies that will attract follow-on investments – and subsequent taxable gains – from venture funds and public equity markets.
- Places more capital in the hands of experienced investors who have previously invested in successful start-up companies.
- Encourages successful entrepreneurs to start and grow successive innovation-based start-up companies.
- Provides tax credits only for successful ventures; start-ups that do not succeed will not realize gains and will not receive tax benefits.
- Results in economic growth and job creation before credits are allowed.
- Minimal initial fiscal impact if eligibility is limited to investment after date of enactment.

## **Credit Structure**

Eligibility for the proposed exclusion would be limited to investors and companies qualified under North Carolina's existing Qualified Business Venture (QBV) Tax Credit. In addition, the exclusion would be available only for investments made after the effective date of the proposed legislation. The exclusion would provide for recapture of QBV credits taken by investors at the time of their investment. The exclusion would not be available for securities purchased in connection with certain redemptions after transactions substantially limiting risk of loss to the investor.

## **Fiscal and Economic Impact**

Seed and other early stage investments in start-up companies are in the range of \$50,000 to \$1,000,000. Typically these initial investments are followed by subsequent equity rounds funded by venture capitalists and public equity markets. In 2008, start-up companies in North Carolina attracted just over \$564 million in funding from angel and venture investors. Since 1999, angel and venture-backed companies in North Carolina have attracted more than \$7.6 billion in investments, excluding IPOs. The proposed legislation would make nearly all such follow-on investments ineligible for the proposed exclusion. Therefore, although the fiscal impact of the proposed exclusion will be driven largely by small, early stage investments, the overall economic impact of the proposal will be driven by follow-on investments likely to be exponentially larger. Taxation of these cash flows may well result in additional state revenues that substantially offset, or even exceed, the fiscal impact of the proposed exclusion. Moreover, because follow-on equity investments will typically precede initial investors' cash outs, the state is likely to derive material revenue gains from the proposed exclusion even before negative fiscal impacts of the exclusion are realized.

For more information on the Qualified Business Venture Founders Credit or other contents of this Fact Sheet, contact Sam Taylor at the North Carolina Biosciences Organization, P.O. Box 14314, Research Triangle Park, NC 27709; Telephone: (919) 281-8960 or (919) 306-1030; E-mail: [staylor@ncbioscience.org](mailto:staylor@ncbioscience.org).