

**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003**

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SENATE DRS75214-LC-94 (03/26)

Short Title: Small Business Capital Gains Exclusion. (Public)

Sponsors: Senator Queen.

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO EXCLUDE FROM INCOME TAX CERTAIN GAINS FROM
3 INVESTMENTS IN QUALIFIED SMALL BUSINESSES.

4 The General Assembly of North Carolina enacts:

5 **SECTION 1.** This act is the Small Business Exclusion of Gain Act.

6 **SECTION 2.** G.S. 105-130.5(b) is amended by adding a new subdivision to
7 read:

8 "(22) The amount of the exclusion of gain for qualified businesses
9 allowed under Part 5 of this Article, to the extent included in
10 federal taxable income."

11 **SECTION 3.** G.S. 105-134.6(b) is amended by adding a new subdivision to
12 read:

13 "(18) The amount of the exclusion of gain for qualified businesses
14 allowed under Part 5 of this Article."

15 **SECTION 4.** G.S. 105-163.013 and G.S. 105-163.015 are recodified as
16 G.S. 105-163.010A and G.S. 105-163.010B, respectively.

17 **SECTION 5.** Part 5 of Article 4 of Chapter 105 of the General Statutes, as
18 amended by this act, reads as rewritten:

19 "Part 5. Tax ~~Credits-Incentives~~ for Qualified Business Investments.

20 "Subpart 1. General Provisions.

21 **"§ 105-163.010. Definitions.**

22 The following definitions apply in this Part:

- 23 (1) Affiliate. – An individual or business that controls, is controlled by, or
24 is under common control with another individual or business.
25 (2) Business. – A corporation, partnership, limited liability company,
26 association, or sole proprietorship operated for profit.

- 1 (3) Control. – A person controls an entity if the person owns, directly or
2 indirectly, more than ten percent (10%) of the voting securities of that
3 entity. As used in this subdivision, the term "voting security" means a
4 security that (i) confers upon the holder the right to vote for the
5 election of members of the board of directors or similar governing
6 body of the business or (ii) is convertible into, or entitles the holder to
7 receive upon its exercise, a security that confers such a right to vote. A
8 general partnership interest is a voting security.
- 9 (4) Equity security. – Common stock, preferred stock, or an interest in a
10 ~~partnership, partnership or limited liability company~~, or subordinated
11 debt that is convertible into, or entitles the holder to receive upon its
12 exercise, common stock, preferred stock, or an interest in a
13 ~~partnership, partnership or limited liability company~~.
- 14 (5) Financial institution. – A business that is (i) a bank holding company,
15 as defined in the Bank Holding Company Act of 1956, 12 U.S.C. §§
16 1841, et seq., or its wholly owned subsidiary, (ii) registered as a
17 broker-dealer under the Securities Exchange Act of 1934, 15 U.S.C. §§
18 78a, et seq., or its wholly owned subsidiary, (iii) an investment
19 company as defined in the Investment Company Act of 1940, 15
20 U.S.C. §§ 80a-1, et seq., whether or not it is required to register under
21 that act, (iv) a small business investment company as defined in the
22 Small Business Investment Act of 1958, 15 U.S.C. §§ 661, et seq., (v)
23 a pension or profit-sharing fund or trust, or (vi) a bank, savings
24 institution, trust company, financial services company, or insurance
25 company. The term does not include, however, a business, other than a
26 small business investment company, whose net worth, when added to
27 the net worth of all of its affiliates, is less than ten million dollars
28 (\$10,000,000). The term also does not include a business that does not
29 generally market its services to the public and is controlled by a
30 business that is not a financial institution.
- 31 (6) North Carolina Enterprise Corporation. – A corporation established in
32 accordance with Article 3 of Chapter 53A of the General Statutes or a
33 limited partnership in which a North Carolina Enterprise Corporation
34 is the only general partner.
- 35 (7) Pass-through entity. – An entity or a business, including a limited
36 partnership, a general partnership, a joint venture, a Subchapter S
37 Corporation, or a limited liability company, all of which is treated as
38 owned by individuals or other entities under the federal tax laws, in
39 which the owners report their share of the income, losses, and credits
40 from the entity or business on their income tax returns filed with this
41 State. For the purpose of this Part, an owner of a pass-through entity is
42 an individual or entity who is treated as an owner under the federal tax
43 laws.

- 1 (8) Qualified business venture. – A business that (i) engages primarily in
2 manufacturing, processing, warehousing, wholesaling, research and
3 development, or a service-related industry, and (ii) is registered with
4 the Secretary of State under ~~G.S. 105-163.013~~G.S. 105-163.010A.
- 5 (9) Qualified grantee business. – A business that (i) is registered with the
6 Secretary of State under ~~G.S. 105-163.013~~G.S. 105-163.010A, and (ii)
7 has received during the preceding three years a grant or other funding
8 from a federal agency under the Small Business Innovation Research
9 Program administered by the United States Small Business
10 Administration or from an organization that meets any of the following
11 qualifications:
- 12 a. It is a domestic or foreign corporation that (i) is tax-exempt
13 pursuant to section 501(c)(3) of the Code, (ii) has as its
14 principal purpose the stimulation of the development of the
15 biotechnology industry, and (iii) in furtherance of that purpose
16 has received, or is a successor in interest to an organization that
17 has received, direct appropriations from the State in at least
18 three fiscal years.
- 19 b. It is a domestic or foreign corporation that (i) is tax-exempt
20 pursuant to section 501(c)(3) of the Code, (ii) has as its
21 principal purpose the stimulation of the development of the
22 microelectronics and communication industries, and (iii) in
23 furtherance of that purpose has received, or is a successor in
24 interest to an organization that has received, direct
25 appropriations from the State in at least three fiscal years.
- 26 c. It is an institute that (i) is administratively located within a
27 constituent institution of The University of North Carolina, (ii)
28 is financed in part by a domestic or foreign corporation that is
29 tax-exempt pursuant to section 501(c)(3) of the Code, (iii) has
30 as a principal purpose the stimulation of economic development
31 based on the advancement of science, engineering, and
32 technology, and (iv) funds, either directly or in collaboration
33 with other entities, small businesses engaging in developing
34 technology.
- 35 (9b) Qualified North Carolina business. – A qualified business venture or a
36 qualified grantee business.
- 37 (10) Real estate-related business. – A business that is involved in or related
38 to the brokerage, selling, purchasing, leasing, operating, or managing
39 of hotels, motels, nursing homes or other lodging facilities, golf
40 courses, sports or social clubs, restaurants, storage facilities, or
41 commercial or residential lots or buildings is a real estate-related
42 business, except that a real estate-related business does not include (i)
43 a business that purchases or leases real estate from others for the
44 purpose of providing itself with facilities from which to conduct a

1 business that is not itself a real estate-related business or (ii) a business
2 that is not otherwise a real estate-related business but that leases,
3 subleases, or otherwise provides to one or more other persons a
4 number of square feet of space which in the aggregate does not exceed
5 fifty percent (50%) of the number of square feet of space occupied by
6 the business for its other activities.

7 (10a) Related person. – A person described in one of the relationships set
8 forth in section 267(b) or 707(b) of the Code.

9 (11) Security. – A security as defined in Section 2(1) of the Securities Act
10 of 1933, 15 U.S.C. § 77b(1).

11 (12) Selling or leasing at retail. – ~~A business is selling or leasing at retail if~~
12 ~~the business either (i) sells or leases any product or~~Any of the
13 following:

14 a. Selling or leasing any service of any nature from a store or
15 other location open to the public ~~generally or (ii) sells or leases~~
16 ~~products or generally.~~

17 b. Selling or leasing services of any nature by means other than to
18 or through one or more other businesses.

19 c. Reselling or leasing at retail products that are purchased or
20 leased at wholesale and then resold or leased substantially
21 unmodified.

22 (13) Service-related industry. – A business is engaged in a service-related
23 industry, whether or not it also sells a product, if it provides services to
24 customers or clients and does not as a substantial part of its business
25 engage in a business described in G.S. 105-163.010A(b)(4).
26 ~~G.S. 105-163.013(b)(4).~~ A business is engaged as a substantial part of
27 its business in an activity described in G.S. 105-163.010A(b)(4)
28 ~~G.S. 105-163.013(b)(4)~~ if (i) its gross revenues derived from all
29 activities described in that subdivision exceed twenty-five percent
30 (25%) of its gross revenues in any fiscal year or (ii) it is established as
31 one of its primary purposes to engage in any activities described in that
32 subdivision, whether or not its purposes were stated in its articles of
33 incorporation or similar organization documents.

34 (14) Subordinated debt. – Indebtedness that is not secured and is
35 subordinated to all other indebtedness of the issuer issued or to be
36 issued to a financial institution other than a financial institution
37 described in subdivisions (5)(ii) through (5)(v) of this section. ~~Except~~
38 For the purposes of Subpart 2 of this Part only, except as provided in
39 G.S. 105-163.014(d1), any portion of indebtedness that matures earlier
40 than five years after its issuance is not subordinated debt.

41 **"§ 105-163.010A. Registration.**

42 (a) Repealed by Session Laws 1993, c. 443, s. 4.

43 (b) Qualified Business Ventures. – In order to qualify as a qualified business
44 venture under this Part, a business must be registered with the Securities Division of the

1 Department of the Secretary of State. To register, the business must file with the
2 Secretary of State an application and any supporting documents the Secretary of State
3 may require from time to time to determine that the business meets the requirements for
4 registration as a qualified business venture. A business meets the requirements for
5 registration as a qualified business venture if all of the following are true as of the date
6 the business files the required application:

7 (1) Repealed by Session Laws 1996, Second Extra Session, c. 14, s. 7.

8 (1a) Reserved for future codification purposes.

9 (1b) Either (i) it was organized after January 1 of the calendar year in which
10 its application is filed or (ii) during its most recent fiscal year before
11 filing the application, it had gross revenues, as determined in
12 accordance with generally accepted accounting principles, of five
13 million dollars (\$5,000,000) or less on a consolidated basis.

14 (2) Repealed by Session Laws 1996, Second Extra Session, c. 14, s. 7.

15 (3) It is organized to engage primarily in manufacturing, processing,
16 warehousing, wholesaling, research and development, or a
17 service-related industry.

18 (4) It does not engage as a substantial part of its business in any of the
19 following:

20 a. Providing a professional service as defined in Chapter 55B of
21 the General Statutes.

22 b. Construction or contracting.

23 c. Selling or leasing at retail.

24 d. The purchase, sale, or development, or purchasing, selling, or
25 holding for investment of commercial paper, notes, other
26 indebtedness, financial instruments, securities, or real property,
27 or otherwise make investments.

28 e. Providing personal grooming or cosmetics services.

29 f. Offering any form of entertainment, amusement, recreation, or
30 athletic or fitness activity for which an admission or a
31 membership is charged.

32 (5) It was not formed for the primary purpose of acquiring all or part of
33 the ~~stock~~stock, other ownership interest, or assets of one or more
34 existing businesses.

35 (6) It is not a real estate-related business.

36 The effective date of registration for a qualified business venture whose application
37 is accepted for registration is 60 days before the date its application is filed. No credit or
38 exclusion of gain is allowed under this Part for an investment made before the effective
39 date of the registration or after the registration is revoked. For the purpose of this
40 Article, if a taxpayer's investment is placed initially in escrow conditioned upon other
41 investors' commitment of additional funds, the date of the investment is the date
42 escrowed funds are transferred to the qualified business venture free of the condition.

43 To remain qualified as a qualified business venture, the business must renew its
44 registration annually as prescribed by rule by filing a financial statement for the most

1 recent fiscal year showing gross revenues, as determined in accordance with generally
2 accepted accounting principles, of five million dollars (\$5,000,000) or less on a
3 consolidated basis and an application for renewal in which the business certifies the
4 facts required in the original application.

5 Failure of a qualified business venture to renew its registration by the applicable
6 deadline ~~shall result~~ results in revocation of its registration effective as of the next day
7 after the renewal deadline, but ~~shall~~ does not result in forfeiture of tax credits previously
8 allowed to taxpayers who invested in the business except as provided in
9 G.S. 105-163.014. The Secretary of State shall send the qualified business venture
10 notice of revocation within 60 days after the renewal deadline. A qualified business
11 venture may apply to have its registration reinstated by the Secretary of State by filing
12 an application for reinstatement, accompanied by the reinstatement application fee and a
13 late filing penalty of one thousand dollars (\$1,000), within 30 days after receipt of the
14 revocation notice from the Secretary of State. A business that seeks approval of a new
15 application for registration after its registration has been revoked must also pay a
16 penalty of one thousand dollars (\$1,000). A registration that has been reinstated is
17 treated as if it had not been revoked.

18 If the gross revenues of a qualified business venture exceed five million dollars
19 (\$5,000,000) in a fiscal year, the business must notify the Secretary of State in writing
20 of this fact by filing a financial statement showing the revenues of the business for that
21 year.

22 (c) Qualified Grantee Businesses. – In order to qualify as a qualified grantee
23 business under this Part, a business must be registered with the Securities Division of
24 the Department of the Secretary of State. To register, the business must file with the
25 Secretary of State an application and any supporting documents the Secretary of State
26 may require from time to time to determine that the business meets the requirements for
27 registration as a qualified grantee business. The requirements for registration as a
28 qualified grantee business are set out in G.S. 105-163.010(9).

29 The effective date of registration for a qualified grantee business whose application
30 is accepted for registration is the filing date of its application. No credit or exclusion of
31 gain is allowed under this Part for an investment made before the effective date of the
32 registration or after the registration is revoked.

33 To remain qualified as a qualified grantee business, the business must renew its
34 registration annually as prescribed by rule by filing an application for renewal in which
35 the business certifies the facts ~~listed in this subsection~~ required for initial registration.

36 (d) Application Forms; Rules; Fees. – Applications for registration, renewal of
37 registration, and reinstatement of registration under this section shall be in the form
38 required by the Secretary of State. The Secretary of State may, by rule, require
39 applicants to furnish supporting information in addition to the information required by
40 subsections (b) and (c) of this section. The Secretary of State may adopt rules in
41 accordance with Chapter 150B of the General Statutes that are needed to carry out the
42 Secretary's responsibilities under this Part. The Secretary of State shall prepare blank
43 forms for the applications and shall distribute them throughout the State and furnish
44 them on request. Each application ~~shall be signed by the owners of the business or, in~~

1 ~~the case of a corporation, by its president, vice president, treasurer, or secretary, must be~~
2 ~~signed by the owners, a manager, or an executive officer of the business.~~ There shall be
3 annexed to the application the affirmation of the person making the application in the
4 following form: "Under penalties prescribed by law, I certify and affirm that to the best
5 of my knowledge and belief this application is true and complete." A person who
6 submits a false application is guilty of a Class 1 misdemeanor.

7 The fee for filing an application for registration under this section is one hundred
8 dollars (\$100.00). The fee for filing an application for renewal of registration under this
9 section is fifty dollars (\$50.00). The fee for filing an application for reinstatement of
10 registration under this section is fifty dollars (\$50.00).

11 An application for renewal of registration under this section shall indicate whether
12 the applicant is a minority business, as defined in G.S. 143-128, and shall include a
13 report of the number of jobs the business created during the preceding year that are
14 attributable to investments that qualify under this section for a tax credit and the average
15 wages paid by each job. An application that does not contain this information is
16 incomplete and the applicant's registration may not be renewed until the information is
17 provided.

18 (e) Revocation of Registration. – If the Securities Division of the Department of
19 the Secretary of State finds that any of the information contained in an application of a
20 business registered under this section is false, it shall revoke the registration of the
21 business. The Secretary of State shall not revoke the registration of a business solely
22 because it ceases business operations for an indefinite period of time, as long as the
23 business renews its registration each year as required under G.S. 105-163.010A.
24 ~~G.S. 105-163.013.~~

25 (f) Transfer of Registration. – A registration as a qualified business venture or
26 qualified grantee business may not be sold or otherwise transferred, except that if a
27 qualified business venture or qualified grantee business enters into a merger,
28 conversion, consolidation, or other similar transaction with another business and the
29 surviving company would otherwise meet the criteria for being a qualified business
30 venture or qualified grantee business, the surviving company retains the registration
31 without further application to the Secretary of State. In such a case, the qualified
32 business venture or qualified grantee business shall provide the Secretary of State with
33 written notice of the merger, conversion, consolidation, or similar transaction and the
34 name, address, and jurisdiction of incorporation or organization of the surviving
35 company.

36 (g) Report by Secretary of State. – The Secretary of State shall report to the
37 Revenue Laws Study Committee by October 1 of each year all of the businesses that
38 have registered with the Secretary of State as qualified business ventures and qualified
39 grantee businesses. The report shall include the name and address of each business, the
40 location of its headquarters and principal place of business, a detailed description of the
41 types of business in which it engages, whether the business is a minority business as
42 defined in G.S. 143-128, the number of jobs created by the business during the period
43 covered by the report, and the average wages paid by these jobs.

44 **"§ 105-163.010B. Sunset.**

1 ~~This Subpart 2 of this Part is repealed effective for investments made on or after~~
2 ~~January 1, 2004. Subpart 3 of this Part is repealed effective for investments made on or~~
3 ~~after January 1, 2008.~~

4 "Subpart 2. Tax Credits for Qualified Business Investments.

5 **"§ 105-163.011. Tax credits allowed.**

6 (a) No Credit for Brokered Investments. – No credit is allowed under this section
7 for a purchase of equity securities or subordinated debt if a broker's fee or commission
8 or other similar remuneration is paid or given directly or indirectly for soliciting the
9 purchase.

10 (b) Individuals. – Subject to the limitations contained in G.S. 105-163.012, an
11 individual who purchases the equity securities or subordinated debt of a qualified
12 business venture or a qualified grantee business directly from that business is allowed as
13 a credit against the tax imposed by Part 2 of this Article for the taxable year an amount
14 equal to twenty-five percent (25%) of the amount invested. The aggregate amount of
15 credit allowed an individual for one or more investments in a single taxable year under
16 this Part, whether directly or indirectly as owner of a pass-through entity, may not
17 exceed fifty thousand dollars (\$50,000). The credit may not be taken for the year in
18 which the investment is made but shall be taken for the taxable year beginning during
19 the calendar year in which the application for the credit becomes effective as provided
20 in subsection (c) of this section.

21 (b1) Pass-Through Entities. – This subsection does not apply to a pass-through
22 entity that has committed capital under management in excess of five million dollars
23 (\$5,000,000) or to a pass-through entity that is a qualified grantee business, a qualified
24 business venture, or a North Carolina Enterprise Corporation. Subject to the limitations
25 provided in G.S. 105-163.012, a pass-through entity that purchases the equity securities
26 or subordinated debt of a qualified grantee business or a qualified business venture
27 directly from the business is eligible for a tax credit equal to twenty-five percent (25%)
28 of the amount invested. The aggregate amount of credit allowed a pass-through entity
29 for one or more investments in a single taxable year under this Part, whether directly or
30 indirectly as owner of another pass-through entity, may not exceed seven hundred fifty
31 thousand dollars (\$750,000). The pass-through entity is not eligible for the credit for the
32 year in which the investment by the pass-through entity is made but shall be eligible for
33 the credit for the taxable year beginning during the calendar year in which the
34 application for the credit becomes effective as provided in subsection (c) of this section.

35 Each individual who is an owner of a pass-through entity is allowed as a credit
36 against the tax imposed by Part 2 of this Article for the taxable year an amount equal to
37 the owner's allocated share of the credits for which the pass-through entity is eligible
38 under this subsection. The aggregate amount of credit allowed an individual for one or
39 more investments in a single taxable year under this Part, whether directly or indirectly
40 as owner of a pass-through entity, may not exceed fifty thousand dollars (\$50,000).

41 If an owner's share of the pass-through entity's credit is limited due to the maximum
42 allowable credit under this section for a taxable year, the pass-through entity and its
43 owners may not reallocate the unused credit among the other owners.

1 (c) Application. – To be eligible for the tax credit provided in this section, the
2 taxpayer must file an application for the credit with the Secretary on or before April 15
3 of the year following the calendar year in which the investment was made. The
4 Secretary may grant extensions of this deadline, as the Secretary finds appropriate, upon
5 the request of the taxpayer, except that the application may not be filed after September
6 15 of the year following the calendar year in which the investment was made. An
7 application is effective for the year in which it is timely filed. The application shall be
8 on a form prescribed by the Secretary and shall include any supporting documentation
9 that the Secretary may require. If an investment for which a credit is applied for was
10 paid for other than in money, the taxpayer shall include with the application a certified
11 appraisal of the value of the property used to pay for the investment. The application for
12 a credit for an investment made by a pass-through entity must be filed by the
13 pass-through entity.

14 (d) Penalties. – The penalties provided in G.S. 105-236 apply in this Part.

15 **"§ 105-163.012. Limit; carry-over; ceiling; reduction in basis.**

16 (a) The credit allowed a taxpayer under G.S. 105-163.011 may not exceed the
17 amount of income tax imposed by Part 2 of this Article for the taxable year reduced by
18 the sum of all other credits allowable except tax payments made by or on behalf of the
19 taxpayer. The amount of unused credit allowed under G.S. 105-163.011 may be carried
20 forward for the next five succeeding years. The fifty thousand dollar (\$50,000)
21 limitation on the amount of credit allowed a taxpayer under G.S. 105-163.011 does not
22 apply to unused amounts carried forward under this subsection.

23 (b) The total amount of all tax credits allowed to taxpayers under
24 G.S. 105-163.011 for investments made in a calendar year may not exceed six million
25 dollars (\$6,000,000). The Secretary of Revenue shall calculate the total amount of tax
26 credits claimed from the applications filed pursuant to G.S. 105-163.011(c). If the total
27 amount of tax credits claimed for investments made in a calendar year exceeds six
28 million dollars (\$6,000,000), the Secretary shall allow a portion of the credits claimed
29 by allocating a total of six million dollars (\$6,000,000) in tax credits in proportion to the
30 size of the credit claimed by each taxpayer.

31 (c) If a credit claimed under G.S. 105-163.011 is reduced as provided in this
32 section, the Secretary shall notify the taxpayer of the amount of the reduction of the
33 credit on or before December 31 of the year following the calendar year in which the
34 investment was made. The Secretary's allocations based on applications filed pursuant
35 to G.S. 105-163.011(c) are final and shall not be adjusted to account for credits applied
36 for but not claimed.

37 (d) The taxpayer's basis in the equity securities or subordinated debt acquired as a
38 result of an investment in a qualified business venture or qualified grantee business shall
39 be reduced for the purposes of this Article by the amount of allowable credit.
40 "Allowable credit" means the amount of credit allowed under G.S. 105-163.011 reduced
41 as provided in subsection (c) of this section.

42 **"§ 105-163.013. Recodified as G.S. 105-163.010A.**

43 **"§ 105-163.014. Forfeiture of credit.**

1 (a) Participation in Business. – A taxpayer who has received a credit under this
2 Part for an investment in a qualified business venture or qualified grantee business
3 forfeits the credit if, within three years after the investment was made, the taxpayer
4 participates in the operation of the qualified business venture or qualified grantee
5 business. For the purpose of this section, a taxpayer participates in the operation of a
6 qualified business venture or a qualified grantee business if the taxpayer, the taxpayer's
7 spouse, parent, sibling, or child, or an employee of any of these individuals or of a
8 business controlled by any of these individuals, provides services of any nature to the
9 qualified business venture or qualified grantee business for compensation, whether as an
10 employee, a contractor, or otherwise. However, a person who provides services to a
11 qualified business venture or a qualified grantee business, whether as an officer, a
12 member of the board of directors, or otherwise does not participate in its operation if the
13 person receives as compensation only reasonable reimbursement of expenses incurred in
14 providing the services, participation in a stock option or stock bonus plan, or both.

15 (b) False Application. – A taxpayer who has received a credit under this Part for
16 an investment in a qualified business venture or a qualified grantee business forfeits the
17 credit if the registration of the qualified business venture or qualified grantee business is
18 revoked because information in the registration application was false at the time the
19 application was filed with the Secretary of State.

20 (c) Repealed by Session Laws 1996, Second Extra Session, c. 14, s. 7.

21 (d) Transfer or Redemption of Investment. – A taxpayer who has received a
22 credit under this Part for an investment in a qualified business venture or a qualified
23 grantee business forfeits the credit in the following cases:

- 24 (1) Within one year after the investment was made, the taxpayer transfers
25 any of the securities received in the investment that qualified for the
26 tax credit to another person or entity, other than in a transfer resulting
27 from one of the following:
28 a. The death of the taxpayer.
29 b. A final distribution in liquidation to the owners of a taxpayer
30 that is a corporation or other entity.
31 c. A merger, conversion, consolidation, or similar transaction
32 requiring approval by the owners of the qualified business
33 venture or qualified grantee business under applicable State
34 law, to the extent the taxpayer does not receive cash or tangible
35 property in the merger, conversion, consolidation, or other
36 similar transaction.

- 37 (2) Except as provided in subsection (d1) of this section, within five years
38 after the investment was made, the qualified business venture or
39 qualified grantee business in which the investment was made makes a
40 redemption with respect to the securities received in the investment.

41 In the event the taxpayer transfers fewer than all the securities in a manner that
42 would result in a forfeiture, the amount of the credit that is forfeited is the product
43 obtained by multiplying the aggregate credit attributable to the investment by a fraction
44 whose numerator equals the number of securities transferred and whose denominator

1 equals the number of securities received on account of the investment to which the
2 credit was attributable. In addition, if the redemption amount is less than the amount
3 invested by the taxpayer in the securities to which the redemption is attributable, the
4 amount of the credit that is forfeited is further reduced by multiplying it by a fraction
5 whose numerator equals the redemption amount and whose denominator equals the
6 aggregate amount invested by the taxpayer in the securities involved in the redemption.
7 The term "redemption amount" means all amounts paid that are treated as a distribution
8 in part or full payment in exchange for securities under section 302(a) of the Code.

9 (d1) Certain Redemptions Allowed. – Forfeiture of a credit does not occur under
10 this section if a qualified business venture that engages primarily in motion picture film
11 production makes a redemption with respect to securities received in an investment and
12 the following conditions are met:

- 13 (1) The redemption occurred because the qualified business venture
14 completed production of a film, sold the film, and was liquidated.
- 15 (2) Neither the qualified business venture nor a related person continues to
16 engage in business with respect to the film produced by the qualified
17 business venture.

18 (e) Effect of Forfeiture. – A taxpayer who forfeits a credit under this section is
19 liable for all past taxes avoided as a result of the credit plus interest at the rate
20 established under G.S. 105-241.1(i), computed from the date the taxes would have been
21 due if the credit had not been allowed. The past taxes and interest are due 30 days after
22 the date the credit is forfeited; a taxpayer who fails to pay the past taxes and interest by
23 the due date is subject to the penalties provided in G.S. 105-236.

24 **"§ 105-163.015. Recodified as G.S. 105-163.010B.**

25 "Subpart 3. Exclusion of Gain for Qualified Business Investments.

26 **"§ 105-163.020. Exclusion of gain allowed.**

27 (a) Any gain recognized for federal income tax purposes from the sale or
28 exchange of qualified securities is excluded from taxation under this Article if the sale
29 or exchange occurs on or after January 1, 2008.

30 (b) A taxpayer who is an owner of a pass-through entity may exclude from the
31 taxpayer's income taxable under this Article an amount equal to the taxpayer's allocated
32 share of the exclusion for which the pass-through entity is eligible under subsection (a)
33 of this section.

34 **"§ 105-163.021. Qualified securities.**

35 (a) Qualified Security. – Except as otherwise provided in this section, any equity
36 security or subordinated debt instrument issued by a qualified North Carolina business
37 is a qualified security if it satisfies all of the following conditions:

- 38 (1) It is originally issued by the business on or after January 1, 2003.
- 39 (2) As of the date of issuance, the issuing business is a qualified North
40 Carolina business.
- 41 (3) The security or instrument is acquired by the taxpayer at its original
42 issue in exchange for any tangible or intangible property or benefit
43 to the business, including cash, promissory notes, services

1 performed, contracts for services to be performed, or other equity
2 securities of the business.

3 (b) Registration. – Securities of a qualified North Carolina business acquired
4 more than 60 days before the effective date of its registration are not qualified
5 securities. Revocation of the registration of a qualified North Carolina business pursuant
6 to G.S. 105-163.010A does not affect the exclusion of gain from qualified securities
7 acquired while the registration was in effect or within 60 days before it became
8 effective.

9 (c) Effect of Redemptions and Other Distributions. – An equity security or
10 subordinated debt instrument is not a qualified security to the extent the taxpayer
11 purchased it with the proceeds of a redemption, dividend, or distribution made by the
12 business that issued the security or instrument. For the purpose of this subsection, when
13 a business makes a redemption, dividend, or distribution during the four-year period
14 beginning two years before the issuance of securities or instruments to a taxpayer, the
15 taxpayer is considered to have used the proceeds of the redemption, dividend, or
16 distribution toward the purchase of the securities or instruments. A redemption,
17 dividend, or distribution occurs when the business issuing the security or instrument
18 does one of the following:

19 (1) Purchases, directly or indirectly, any of its outstanding equity
20 securities or subordinated debt, other than qualified securities, from
21 the taxpayer or a related person.

22 (2) Declares a dividend or makes a distribution with respect to any of
23 its outstanding equity securities or subordinated debt, other than
24 qualified securities, to the taxpayer or a related person. This
25 subdivision does not apply, however, to a distribution in connection
26 with one of the following:

27 a. The reimbursement to the taxpayer of the reasonable costs of
28 forming, syndicating, managing, and operating the business.

29 b. An increase in the taxpayer's taxes, penalties, or interest to the
30 extent the increase is caused by the allocation to the taxpayer of
31 income of the business.

32 The repayment of principal on subordinated debt is a purchase of the debt except to
33 the extent the repayment is repayment of principal due on the subordinated debt at its
34 maturity pursuant to the terms of the subordinated debt instrument. If a transaction is
35 treated under section 304(a) of the Code as a distribution in redemption of the equity
36 securities of a business, that business has, for the purpose of this subsection, purchased
37 an amount of its equity securities equal to the amount treated as such a distribution
38 under section 304(a) of the Code.

39 (d) Conversion of Other Securities. – Any equity security or subordinated debt
40 instrument issued by a business and acquired by the taxpayer solely through the
41 conversion of another equity security or subordinated debt instrument that was issued by
42 the business and was a qualified security in the hands of the taxpayer is considered, for
43 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
44 by the taxpayer on the date the taxpayer acquired the converted qualified security.

1 (e) Transfers. – In the case of a transfer by gift, by death, or from a pass-through
2 entity to one of its owners, the transferee is considered, for the purpose of this section,
3 to have acquired the qualified security in the same manner as the transferor and to have
4 held it during any continuous period immediately preceding the transfer during which it
5 was held or treated as held by the transferor.

6 In the case of a transaction described in section 351 of the Code or a reorganization
7 described in section 368 of the Code, if qualified securities are exchanged for other
8 securities, the other securities are considered, for the purpose of this section, qualified
9 securities acquired on the date the exchanged qualified securities were acquired. In the
10 case of a transaction described in section 351 of the Code, the newly acquired securities
11 are considered qualified securities, however, only if, immediately after the transaction,
12 the corporation issuing the securities owns, directly or indirectly, securities representing
13 control, within the meaning of section 368(c) of the Code, of the corporation whose
14 securities were exchanged.

15 **"§ 105-163.022. Limitations.**

16 (a) Contributions and Exchanges of Property. – In the case of a transaction
17 described in section 351 or 721 of the Code or a reorganization described in section 368
18 of the Code, if a taxpayer contributes property to or exchanges property with a qualified
19 North Carolina business, the following rules apply:

20 (1) Qualified securities exchanged for property. – Except as otherwise
21 provided in subdivision (3) of this subsection, a taxpayer who
22 transfers property to a business in exchange for qualified securities
23 in the business must, for purposes of determining North Carolina
24 taxable income, recognize gain equal to the amount by which the
25 fair market value of the property exceeded the taxpayer's basis in
26 the property on the date the property was exchanged for the
27 qualified securities. This gain must be recognized for the years for
28 which the taxpayer claims an exclusion of gain under this Part with
29 respect to the disposition of qualified securities received in
30 exchange for the property.

31 (2) Contributions to capital. – Except as otherwise provided in
32 subdivision (3) of this subsection, if the adjusted basis of a
33 qualified security is adjusted due to a contribution to capital after
34 the date the qualified security was issued originally, for purposes of
35 determining North Carolina taxable income, the taxpayer must
36 recognize gain equal to the amount by which the fair market value
37 of the contributed property exceeded the taxpayer's basis in the
38 property on the date the property was contributed. This gain must
39 be recognized for the years for which the taxpayer claims an
40 exclusion of gain under this Part with respect to the disposition of
41 the qualified securities.

42 (3) Disposition of contributed property. – If a qualified North Carolina
43 business disposes of property contributed to it, the disposition
44 occurs before the taxpayer who contributed the property claims an

1 exclusion of gain pursuant to this Part with respect to qualified
2 securities affected by the contribution, and the taxpayer recognizes
3 gain from the disposition, then for purposes of subdivisions (1) and
4 (2) of this subsection, the taxpayer's basis in the contributed
5 property is increased by any gain the taxpayer recognized from the
6 disposition.

7 (b) Short Positions. – If a taxpayer has an offsetting short position with respect to
8 any qualified securities, there is no exclusion of gain under this Part from the sale or
9 exchange of the qualified securities unless the taxpayer established the short position on
10 or after January 1, 2008, and elects to recognize gain as if the qualified securities were
11 sold at fair market value on the date the taxpayer first established the short position. For
12 the purposes of this subsection, a taxpayer has an offsetting short position with respect
13 to qualified securities if one of the following conditions is satisfied:

- 14 (1) The taxpayer or a related person has made a short sale of
15 substantially identical property.
16 (2) The taxpayer or a related person has acquired an option to sell
17 substantially identical property at a fixed price.
18 (3) The taxpayer has entered into any other transaction that the
19 Secretary has identified in guidelines adopted under this section as
20 one that substantially reduces the risk of loss from holding the
21 qualified securities.

22 (c) Guidelines. – The Secretary of Revenue must adopt guidelines identifying
23 transactions that substantially reduce the risk of loss from holding qualifying securities
24 for the purpose of subsection (b) of this section. In addition, the Secretary must adopt
25 guidelines identifying activities and situations designed to avoid the purpose of this Part
26 through split-ups, shell corporations, partnerships, or otherwise. There is no exclusion
27 of gain otherwise allowable under this Part to the extent a taxpayer has engaged in an
28 activity or created a situation identified by the Secretary in guidelines as one that is
29 designed to avoid the purpose of this Part."

30 **SECTION 6.** This act is effective when it becomes law. Notwithstanding the
31 provisions of G.S. 105-163.010A as recodified by this act, if a qualified North Carolina
32 business files its application for registration within 60 days after the effective date of
33 this act and the application is accepted, the effective date of the registration is the later
34 of January 1, 2003, or the date the business first issues equity securities or subordinated
35 debt.