

**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003**

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SENATE BILL 906

Short Title: Small Business Capital Gains Exclusion.

(Public)

Sponsors: Senator Queen.

Referred to: Finance.

April 3, 2003

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.
- 27 (3) Control. – A person controls an entity if the person owns, directly or
28 indirectly, more than ten percent (10%) of the voting securities of that
29 entity. As used in this subdivision, the term "voting security" means a

1 security that (i) confers upon the holder the right to vote for the
2 election of members of the board of directors or similar governing
3 body of the business or (ii) is convertible into, or entitles the holder to
4 receive upon its exercise, a security that confers such a right to vote. A
5 general partnership interest is a voting security.

6 (4) Equity security. – Common stock, preferred stock, or an interest in a
7 ~~partnership~~, partnership or limited liability company, or subordinated
8 debt that is convertible into, or entitles the holder to receive upon its
9 exercise, common stock, preferred stock, or an interest in a
10 ~~partnership~~, partnership or limited liability company.

11 (5) Financial institution. – A business that is (i) a bank holding company,
12 as defined in the Bank Holding Company Act of 1956, 12 U.S.C. §§
13 1841, et seq., or its wholly owned subsidiary, (ii) registered as a
14 broker-dealer under the Securities Exchange Act of 1934, 15 U.S.C. §§
15 78a, et seq., or its wholly owned subsidiary, (iii) an investment
16 company as defined in the Investment Company Act of 1940, 15
17 U.S.C. §§ 80a-1, et seq., whether or not it is required to register under
18 that act, (iv) a small business investment company as defined in the
19 Small Business Investment Act of 1958, 15 U.S.C. §§ 661, et seq., (v)
20 a pension or profit-sharing fund or trust, or (vi) a bank, savings
21 institution, trust company, financial services company, or insurance
22 company. The term does not include, however, a business, other than a
23 small business investment company, whose net worth, when added to
24 the net worth of all of its affiliates, is less than ten million dollars
25 (\$10,000,000). The term also does not include a business that does not
26 generally market its services to the public and is controlled by a
27 business that is not a financial institution.

28 (6) North Carolina Enterprise Corporation. – A corporation established in
29 accordance with Article 3 of Chapter 53A of the General Statutes or a
30 limited partnership in which a North Carolina Enterprise Corporation
31 is the only general partner.

32 (7) Pass-through entity. – An entity or a business, including a limited
33 partnership, a general partnership, a joint venture, a Subchapter S
34 Corporation, or a limited liability company, all of which is treated as
35 owned by individuals or other entities under the federal tax laws, in
36 which the owners report their share of the income, losses, and credits
37 from the entity or business on their income tax returns filed with this
38 State. For the purpose of this Part, an owner of a pass-through entity is
39 an individual or entity who is treated as an owner under the federal tax
40 laws.

41 (8) Qualified business venture. – A business that (i) engages primarily in
42 manufacturing, processing, warehousing, wholesaling, research and
43 development, or a service-related industry, and (ii) is registered with
44 the Secretary of State under ~~G.S. 105-163.013~~. G.S. 105-163.010A.

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

1 fifty percent (50%) of the number of square feet of space occupied by
2 the business for its other activities.

3 (10a) Related person. – A person described in one of the relationships set
4 forth in section 267(b) or 707(b) of the Code.

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

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

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

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

15 c. Reselling or leasing at retail products that are purchased or
16 leased at wholesale and then resold or leased substantially
17 unmodified.

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

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

37 **"§ 105-163.010A. Registration.**

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

39 (b) Qualified Business Ventures. – In order to qualify as a qualified business
40 venture under this Part, a business must be registered with the Securities Division of the
41 Department of the Secretary of State. To register, the business must file with the
42 Secretary of State an application and any supporting documents the Secretary of State
43 may require from time to time to determine that the business meets the requirements for
44 registration as a qualified business venture. A business meets the requirements for

1 registration as a qualified business venture if all of the following are true as of the date
2 the business files the required application:

- 3 (1) Repealed by Session Laws 1996, Second Extra Session, c. 14, s. 7.
4 (1a) Reserved for future codification purposes.
5 (1b) Either (i) it was organized after January 1 of the calendar year in which
6 its application is filed or (ii) during its most recent fiscal year before
7 filing the application, it had gross revenues, as determined in
8 accordance with generally accepted accounting principles, of five
9 million dollars (\$5,000,000) or less on a consolidated basis.
10 (2) Repealed by Session Laws 1996, Second Extra Session, c. 14, s. 7.
11 (3) It is organized to engage primarily in manufacturing, processing,
12 warehousing, wholesaling, research and development, or a
13 service-related industry.
14 (4) It does not engage as a substantial part of its business in any of the
15 following:
16 a. Providing a professional service as defined in Chapter 55B of
17 the General Statutes.
18 b. Construction or contracting.
19 c. Selling or leasing at retail.
20 d. The purchase, sale, or development, or purchasing, selling, or
21 holding for investment of commercial paper, notes, other
22 indebtedness, financial instruments, securities, or real property,
23 or otherwise make investments.
24 e. Providing personal grooming or cosmetics services.
25 f. Offering any form of entertainment, amusement, recreation, or
26 athletic or fitness activity for which an admission or a
27 membership is charged.
28 (5) It was not formed for the primary purpose of acquiring all or part of
29 the ~~stock~~stock, other ownership interest, or assets of one or more
30 existing businesses.
31 (6) It is not a real estate-related business.

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

39 To remain qualified as a qualified business venture, the business must renew its
40 registration annually as prescribed by rule by filing a financial statement for the most
41 recent fiscal year showing gross revenues, as determined in accordance with generally
42 accepted accounting principles, of five million dollars (\$5,000,000) or less on a
43 consolidated basis and an application for renewal in which the business certifies the
44 facts required in the original application.

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

14 If the gross revenues of a qualified business venture exceed five million dollars
15 (\$5,000,000) in a fiscal year, the business must notify the Secretary of State in writing
16 of this fact by filing a financial statement showing the revenues of the business for that
17 year.

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

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

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

32 (d) Application Forms; Rules; Fees. – Applications for registration, renewal of
33 registration, and reinstatement of registration under this section shall be in the form
34 required by the Secretary of State. The Secretary of State may, by rule, require
35 applicants to furnish supporting information in addition to the information required by
36 subsections (b) and (c) of this section. The Secretary of State may adopt rules in
37 accordance with Chapter 150B of the General Statutes that are needed to carry out the
38 Secretary's responsibilities under this Part. The Secretary of State shall prepare blank
39 forms for the applications and shall distribute them throughout the State and furnish
40 them on request. Each application ~~shall be signed by the owners of the business or, in~~
41 ~~the case of a corporation, by its president, vice president, treasurer, or secretary~~ must be
42 signed by the owners, a manager, or an executive officer of the business. There shall be
43 annexed to the application the affirmation of the person making the application in the
44 following form: "Under penalties prescribed by law, I certify and affirm that to the best

1 of my knowledge and belief this application is true and complete." A person who
2 submits a false application is guilty of a Class 1 misdemeanor.

3 The fee for filing an application for registration under this section is one hundred
4 dollars (\$100.00). The fee for filing an application for renewal of registration under this
5 section is fifty dollars (\$50.00). The fee for filing an application for reinstatement of
6 registration under this section is fifty dollars (\$50.00).

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

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

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

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

40 **"§ 105-163.010B. Sunset.**

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

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

1 **"§ 105-163.011. Tax credits allowed.**

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

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

17 (b1) Pass-Through Entities. – This subsection does not apply to a pass-through
18 entity that has committed capital under management in excess of five million dollars
19 (\$5,000,000) or to a pass-through entity that is a qualified grantee business, a qualified
20 business venture, or a North Carolina Enterprise Corporation. Subject to the limitations
21 provided in G.S. 105-163.012, a pass-through entity that purchases the equity securities
22 or subordinated debt of a qualified grantee business or a qualified business venture
23 directly from the business is eligible for a tax credit equal to twenty-five percent (25%)
24 of the amount invested. The aggregate amount of credit allowed a pass-through entity
25 for one or more investments in a single taxable year under this Part, whether directly or
26 indirectly as owner of another pass-through entity, may not exceed seven hundred fifty
27 thousand dollars (\$750,000). The pass-through entity is not eligible for the credit for the
28 year in which the investment by the pass-through entity is made but shall be eligible for
29 the credit for the taxable year beginning during the calendar year in which the
30 application for the credit becomes effective as provided in subsection (c) of this section.

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

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

40 (c) Application. – To be eligible for the tax credit provided in this section, the
41 taxpayer must file an application for the credit with the Secretary on or before April 15
42 of the year following the calendar year in which the investment was made. The
43 Secretary may grant extensions of this deadline, as the Secretary finds appropriate, upon
44 the request of the taxpayer, except that the application may not be filed after September

1 15 of the year following the calendar year in which the investment was made. An
2 application is effective for the year in which it is timely filed. The application shall be
3 on a form prescribed by the Secretary and shall include any supporting documentation
4 that the Secretary may require. If an investment for which a credit is applied for was
5 paid for other than in money, the taxpayer shall include with the application a certified
6 appraisal of the value of the property used to pay for the investment. The application for
7 a credit for an investment made by a pass-through entity must be filed by the
8 pass-through entity.

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

10 **"§ 105-163.012. Limit; carry-over; ceiling; reduction in basis.**

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

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

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

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

37 **"§ 105-163.013. Recodified as G.S. 105-163.010A.**

38 **"§ 105-163.014. Forfeiture of credit.**

39 (a) Participation in Business. – A taxpayer who has received a credit under this
40 Part for an investment in a qualified business venture or qualified grantee business
41 forfeits the credit if, within three years after the investment was made, the taxpayer
42 participates in the operation of the qualified business venture or qualified grantee
43 business. For the purpose of this section, a taxpayer participates in the operation of a
44 qualified business venture or a qualified grantee business if the taxpayer, the taxpayer's

1 spouse, parent, sibling, or child, or an employee of any of these individuals or of a
2 business controlled by any of these individuals, provides services of any nature to the
3 qualified business venture or qualified grantee business for compensation, whether as an
4 employee, a contractor, or otherwise. However, a person who provides services to a
5 qualified business venture or a qualified grantee business, whether as an officer, a
6 member of the board of directors, or otherwise does not participate in its operation if the
7 person receives as compensation only reasonable reimbursement of expenses incurred in
8 providing the services, participation in a stock option or stock bonus plan, or both.

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

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

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

18 (1) Within one year after the investment was made, the taxpayer transfers
19 any of the securities received in the investment that qualified for the
20 tax credit to another person or entity, other than in a transfer resulting
21 from one of the following:

22 a. The death of the taxpayer.

23 b. A final distribution in liquidation to the owners of a taxpayer
24 that is a corporation or other entity.

25 c. A merger, conversion, consolidation, or similar transaction
26 requiring approval by the owners of the qualified business
27 venture or qualified grantee business under applicable State
28 law, to the extent the taxpayer does not receive cash or tangible
29 property in the merger, conversion, consolidation, or other
30 similar transaction.

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

35 In the event the taxpayer transfers fewer than all the securities in a manner that
36 would result in a forfeiture, the amount of the credit that is forfeited is the product
37 obtained by multiplying the aggregate credit attributable to the investment by a fraction
38 whose numerator equals the number of securities transferred and whose denominator
39 equals the number of securities received on account of the investment to which the
40 credit was attributable. In addition, if the redemption amount is less than the amount
41 invested by the taxpayer in the securities to which the redemption is attributable, the
42 amount of the credit that is forfeited is further reduced by multiplying it by a fraction
43 whose numerator equals the redemption amount and whose denominator equals the
44 aggregate amount invested by the taxpayer in the securities involved in the redemption.

1 The term "redemption amount" means all amounts paid that are treated as a distribution
2 in part or full payment in exchange for securities under section 302(a) of the Code.

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

7 (1) The redemption occurred because the qualified business venture
8 completed production of a film, sold the film, and was liquidated.

9 (2) Neither the qualified business venture nor a related person continues to
10 engage in business with respect to the film produced by the qualified
11 business venture.

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

18 "**§ 105-163.015. Recodified as G.S. 105-163.010B.**

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

20 "**§ 105-163.020. Exclusion of gain allowed.**

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

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

28 "**§ 105-163.021. Qualified securities.**

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

32 (1) It is originally issued by the business on or after January 1, 2003.

33 (2) As of the date of issuance, the issuing business is a qualified North
34 Carolina business.

35 (3) The security or instrument is acquired by the taxpayer at its original
36 issue in exchange for any tangible or intangible property or benefit
37 to the business, including cash, promissory notes, services
38 performed, contracts for services to be performed, or other equity
39 securities of the business.

40 (b) Registration. – Securities of a qualified North Carolina business acquired
41 more than 60 days before the effective date of its registration are not qualified
42 securities. Revocation of the registration of a qualified North Carolina business pursuant
43 to G.S. 105-163.010A does not affect the exclusion of gain from qualified securities

1 acquired while the registration was in effect or within 60 days before it became
2 effective.

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

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

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

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

23 b. An increase in the taxpayer's taxes, penalties, or interest to the
24 extent the increase is caused by the allocation to the taxpayer of
25 income of the business.

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

33 (d) Conversion of Other Securities. – Any equity security or subordinated debt
34 instrument issued by a business and acquired by the taxpayer solely through the
35 conversion of another equity security or subordinated debt instrument that was issued by
36 the business and was a qualified security in the hands of the taxpayer is considered, for
37 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
38 by the taxpayer on the date the taxpayer acquired the converted qualified security.

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

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

10 **"§ 105-163.022. Limitations.**

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

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

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

37 (3) Disposition of contributed property. – If a qualified North Carolina
38 business disposes of property contributed to it, the disposition
39 occurs before the taxpayer who contributed the property claims an
40 exclusion of gain pursuant to this Part with respect to qualified
41 securities affected by the contribution, and the taxpayer recognizes
42 gain from the disposition, then for purposes of subdivisions (1) and
43 (2) of this subsection, the taxpayer's basis in the contributed

1 property is increased by any gain the taxpayer recognized from the
2 disposition.

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

10 (1) The taxpayer or a related person has made a short sale of
11 substantially identical property.

12 (2) The taxpayer or a related person has acquired an option to sell
13 substantially identical property at a fixed price.

14 (3) The taxpayer has entered into any other transaction that the
15 Secretary has identified in guidelines adopted under this section as
16 one that substantially reduces the risk of loss from holding the
17 qualified securities.

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

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