

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2007

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HOUSE BILL 1538

Short Title: Qualified Venture Capital Gain Exemption. (Public)

Sponsors: Representatives Gibson, Ross (Primary Sponsors); and Faison.

Referred to: Finance.

April 18, 2007

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

5 The General Assembly of North Carolina enacts:

6 **SECTION 1.** G.S. 150-130.5(b) is amended by adding a new subdivision to
7 read:

8 "(b) The following deductions from federal taxable income shall be made in
9 determining State net income:

10 ...

11 (23) The amount of any exclusion of gain for qualified businesses allowed
12 under Part 5 of this Article, to the extent included in federal taxable
13 income, less the amount of the credits recaptured pursuant to
14 G.S. 105-163.021; provided however, that a taxpayer is not required to
15 claim this exclusion."

16 **SECTION 2.** G.S. 105-134.6(b) is amended by adding a new subdivision to
17 read:

18 "(b) Deductions. – The following deductions from taxable income shall be made
19 in calculating North Carolina taxable income, to the extent each item is included in
20 taxable income:

21 ...

22 (19) The amount of the exclusion of gain for qualified businesses allowed
23 under Part 5 of this Article, less the amount of the credits recaptured
24 pursuant to G.S. 105-163.021; provided however, that a taxpayer is not
25 required to claim this exclusion."

26 **SECTION 3.** G.S. 105-163.013 and G.S. 105-163.015 are recodified as
27 G.S. 105-163.010A and G.S. 105-163.010B, respectively.

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

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

2 "Subpart 1. General Provisions.

3 "**§ 105-163.010. Definitions.**

4 The following definitions apply in this Part:

- 5 (1) Affiliate. – An individual or business that controls, is controlled by, or
6 is under common control with another individual or business.
- 7 (2) Business. – A corporation, partnership, limited liability company,
8 association, or sole proprietorship operated for profit.
- 9 (3) Control. – A person controls an entity if the person owns, directly or
10 indirectly, more than ten percent (10%) of the voting securities of that
11 entity. As used in this subdivision, the term "voting security" means a
12 security that (i) confers upon the holder the right to vote for the
13 election of members of the board of directors or similar governing
14 body of the business or (ii) is convertible into, or entitles the holder to
15 receive upon its exercise, a security that confers such a right to vote. A
16 general partnership interest is a voting security.
- 17 (4) Equity security. – Common stock, preferred stock, or an interest in a
18 ~~partnership, partnership or limited liability company,~~ or subordinated
19 debt that is convertible into, or entitles the holder to receive upon its
20 exercise, common stock, preferred stock, or an interest in a
21 ~~partnership, partnership or limited liability company.~~
- 22 (5) Financial institution. – A business that is (i) a bank holding company,
23 as defined in the Bank Holding Company Act of 1956, 12 U.S.C. §§
24 1841, et seq., or its wholly owned subsidiary, (ii) registered as a
25 broker-dealer under the Securities Exchange Act of 1934, 15 U.S.C. §§
26 78a, et seq., or its wholly owned subsidiary, (iii) an investment
27 company as defined in the Investment Company Act of 1940, 15
28 U.S.C. §§ 80a-1, et seq., whether or not it is required to register under
29 that act, (iv) a small business investment company as defined in the
30 Small Business Investment Act of 1958, 15 U.S.C. §§ 661, et seq., (v)
31 a pension or profit-sharing fund or trust, or (vi) a bank, savings
32 institution, trust company, financial services company, or insurance
33 company. The term does not include, however, a business, other than a
34 small business investment company, whose net worth, when added to
35 the net worth of all of its affiliates, is less than ten million dollars
36 (\$10,000,000). The term also does not include a business that does not
37 generally market its services to the public and is controlled by a
38 business that is not a financial institution.
- 39 (5a) Granting entity. – Any of the following:
- 40 a. A domestic or foreign corporation that (i) is tax-exempt
41 pursuant to section 501(c)(3) of the Code, (ii) has as its
42 principal purpose the stimulation of the development of the
43 biotechnology industry, and (iii) in furtherance of that purpose
44 has received, or is a successor in interest to an organization that

- 1 has received, direct appropriations from the State in at least
2 three fiscal years.
- 3 b. A domestic or foreign corporation that meets the following
4 three conditions:
- 5 1. It is tax-exempt pursuant to section 501(c)(3) of the
6 Code, is a private foundation pursuant to section 509 of
7 the Code, or is an affiliate of either of the foregoing.
- 8 2. It has as its principal purpose one of the following:
9 conducting research and development in, or stimulating
10 the development of, electronic, photonic, information, or
11 other technologies, which may include investing in
12 companies that provide research, development, products,
13 or services in these technologies.
- 14 3. It meets one of the following conditions:
- 15 I. It received direct appropriations in furtherance of
16 one of these purposes from the State in at least
17 three fiscal years.
- 18 II. It was organized to perform one of these purposes
19 for an organization that meets condition I of this
20 sub-subdivision.
- 21 III. It is an affiliate of an entity that meets condition II
22 of this sub-subdivision.
- 23 c. An institute that (i) is administratively located within a
24 constituent institution of The University of North Carolina, (ii)
25 is financed in part by a domestic or foreign corporation that is
26 tax-exempt pursuant to section 501(c)(3) of the Code, (iii) has
27 as a principal purpose the stimulation of economic development
28 based on the advancement of science, engineering, and
29 technology, and (iv) funds, either directly or in collaboration
30 with other entities, small businesses engaging in developing
31 technology.
- 32 (6) North Carolina Enterprise Corporation. – A corporation established in
33 accordance with Article 3 of Chapter 53A of the General Statutes or a
34 limited partnership in which a North Carolina Enterprise Corporation
35 is the only general partner.
- 36 (7) Pass-through entity. – Defined in G.S. 105-228.90.
- 37 (7b) Qualified business. – A qualified business venture, a qualified grantee
38 business, or a qualified licensee business.
- 39 (8) Qualified business venture. – A business that (i) engages primarily in
40 manufacturing, processing, warehousing, wholesaling, research and
41 development, or a service-related industry, and (ii) is registered with
42 the Secretary of State under G.S. ~~105-163.013~~, 105-163.010A.
- 43 (9) Qualified grantee business. – A business that (i) is registered with the
44 Secretary of State under G.S. ~~105-163.013~~, 105-163.010A and (ii) has

1 received during the current year or any of the preceding three years a
2 grant, an investment, or other funding from a federal agency under the
3 Small Business Innovation Research Program administered by the
4 United States Small Business Administration or from a granting entity
5 as defined in this section.

6 (9a) Qualified licensee business. – A business that meets all of the
7 following conditions:

8 a. It is registered with the Secretary of State under
9 G.S. ~~105-163.013~~, 105-163.010A.

10 b. During its most recent fiscal year before filing an application
11 for registration under G.S. ~~105-163.013~~, 105-163.010A, it had
12 gross revenues, as determined in accordance with generally
13 accepted accounting principles, of one million dollars
14 (\$1,000,000) or less on a consolidated basis.

15 c. It has been certified by a constituent institution of The
16 University of North Carolina or a research university as
17 currently performing under a licensing agreement with the
18 institution or university for the purpose of commercializing
19 technology developed at the institution or university. For the
20 purpose of this section, a research university is an institution of
21 higher education classified as a Doctoral/Research University,
22 Extensive or Intensive, in the most recent edition of "A
23 Classification of Institutions of Higher Education", the official
24 report of The Carnegie Foundation for the Advancement of
25 Teaching.

26 (10) Real estate-related business. – A business that is involved in or related
27 to the brokerage, selling, purchasing, leasing, operating, or managing
28 of hotels, motels, nursing homes or other lodging facilities, golf
29 courses, sports or social clubs, restaurants, storage facilities, or
30 commercial or residential lots or buildings is a real estate-related
31 business, except that a real estate-related business does not include (i)
32 a business that purchases or leases real estate from others for the
33 purpose of providing itself with facilities from which to conduct a
34 business that is not itself a real estate-related business or (ii) a business
35 that is not otherwise a real estate-related business but that leases,
36 subleases, or otherwise provides to one or more other persons a
37 number of square feet of space which in the aggregate does not exceed
38 fifty percent (50%) of the number of square feet of space occupied by
39 the business for its other activities.

40 (10a) Related person. – A person described in one of the relationships set
41 forth in section 267(b) or 707(b) of the Code.

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

- 1 (12) ~~Selling or leasing at retail. – A business is selling or leasing at retail if~~
2 ~~the business either (i) sells or leases any product or~~ Any of the
3 following:
4 a. Selling or leasing any service of any nature from a store or
5 other location open to the public ~~generally or (ii) sells or leases~~
6 ~~products or generally.~~
7 b. Selling or leasing services of any nature by means other than to
8 or through one or more other businesses.
9 c. Reselling or leasing at retail products that are purchased or
10 leased at wholesale and then resold or leased substantially
11 unmodified.
- 12 (13) Service-related industry. – A business is engaged in a service-related
13 industry, whether or not it also sells a product, if it provides services to
14 customers or clients and does not as a substantial part of its business
15 engage in a business described in
16 G.S. ~~405-163.013(b)(4); 105-163.010A(b)(4)~~. A business is engaged as
17 a substantial part of its business in an activity described in
18 G.S. ~~405-163.013(b)(4); 105-163.010A(b)(4)~~ if (i) its gross revenues
19 derived from all activities described in that subdivision exceed
20 twenty-five percent (25%) of its gross revenues in any fiscal year or
21 (ii) it is established as one of its primary purposes to engage in any
22 activities described in that subdivision, whether or not its purposes
23 were stated in its articles of incorporation or similar organization
24 documents.
- 25 (14) Subordinated debt. – Indebtedness that is not secured and is
26 subordinated to all other indebtedness of the issuer issued or to be
27 issued to a financial institution other than a financial institution
28 described in subdivisions (5)(ii) through (5)(v) of this section. ~~Except~~
29 For the purposes of Subpart 2 of this Part only, except as provided in
30 G.S. 105-163.014(d1), any portion of indebtedness that matures earlier
31 than five years after its issuance is not subordinated debt.

32 "**§ 105-163.010A. Registration.**

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

34 (b) Qualified Business Ventures. – In order to qualify as a qualified business
35 venture under this Part, a business must be registered with the Securities Division of the
36 Department of the Secretary of State. To register, the business must file with the
37 Secretary of State an application and any supporting documents the Secretary of State
38 may require from time to time to determine that the business meets the requirements for
39 registration as a qualified business venture. A business meets the requirements for
40 registration as a qualified business venture if all of the following are true as of the date
41 the business files the required application:

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

43 (1a) Reserved for future codification purposes.

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

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

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

42 Failure of a qualified business venture to renew its registration by the applicable
43 deadline ~~shall result~~results in revocation of its registration effective as of the next day
44 after the renewal deadline, but ~~shall~~does not result in forfeiture of tax credits previously

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

11 If the gross revenues of a qualified business venture exceed five million dollars
12 (\$5,000,000) in a fiscal year, the business must notify the Secretary of State in writing
13 of this fact by filing a financial statement showing the revenues of the business for that
14 year.

15 (b1) Qualified Licensee Businesses. – In order to qualify as a qualified licensee
16 business under this Part, a business must be registered with the Securities Division of
17 the Department of the Secretary of State. To register, the business must file with the
18 Secretary of State an application and any supporting documents the Secretary of State
19 may require from time to time to determine that the business meets the requirements for
20 registration as a qualified licensee business. The requirements for registration as a
21 qualified licensee business are set out in G.S. 105-163.010.

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

26 To remain qualified as a qualified licensee business, the business must renew its
27 registration annually as prescribed by rule by filing a financial statement for the most
28 recent fiscal year showing gross revenues, as determined in accordance with generally
29 accepted accounting principles, of one million dollars (\$1,000,000) or less on a
30 consolidated basis and an application for renewal in which the business certifies the
31 facts required in the original application.

32 Failure of a qualified licensee ~~venture-business~~ to renew its registration by the
33 applicable deadline results in revocation of its registration effective as of the next day
34 after the renewal deadline, but does not result in forfeiture of tax credits previously
35 allowed to taxpayers who invested in the business except as provided in
36 G.S. 105-163.014. The Secretary of State shall send the qualified licensee business
37 notice of revocation within 60 days after the renewal deadline. A qualified licensee
38 business may apply to have its registration reinstated by the Secretary of State by filing
39 an application for reinstatement, accompanied by the reinstatement application fee and a
40 late filing penalty of one thousand dollars (\$1,000), within 30 days after receipt of the
41 revocation notice from the Secretary of State. A business that seeks approval of a new
42 application for registration after its registration has been revoked must also pay a
43 penalty of one thousand dollars (\$1,000). A registration that has been reinstated is
44 treated as if it had not been revoked.

1 If the gross revenues of a qualified licensee business ~~venture~~ exceed one million
2 dollars (\$1,000,000) in a fiscal year, the business must notify the Secretary of State in
3 writing of this fact by filing a financial statement showing the revenues of the business
4 for that year.

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

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

16 To remain qualified as a qualified grantee business, the business must renew its
17 registration annually as prescribed by rule by filing an application for renewal in which
18 the business certifies the facts demonstrating that it continues to meet the applicable
19 requirements for qualification.

20 (d) Application Forms; Rules; Fees. – Applications for registration, renewal of
21 registration, and reinstatement of registration under this section shall be in the form
22 required by the Secretary of State. The Secretary of State may, by rule, require
23 applicants to furnish supporting information in addition to the information required by
24 subsections (b), (b1), and (c) of this section. The Secretary of State may adopt rules in
25 accordance with Chapter 150B of the General Statutes that are needed to carry out the
26 Secretary's responsibilities under this Part. The Secretary of State shall prepare blank
27 forms for the applications and shall distribute them throughout the State and furnish
28 them on request. ~~Each application shall be signed by the owners of the business or, in~~
29 ~~the case of a corporation, by its president, vice president, treasurer, or secretary.~~ must be
30 signed by the owners, a manager, or an executive officer of the business. There shall be
31 annexed to the application the affirmation of the person making the application in the
32 following form: "Under penalties prescribed by law, I certify and affirm that to the best
33 of my knowledge and belief this application is true and complete." A person who
34 submits a false application is guilty of a Class 1 misdemeanor.

35 The fee for filing an application for registration under this section is one hundred
36 dollars (\$100.00). The fee for filing an application for renewal of registration under this
37 section is fifty dollars (\$50.00). The fee for filing an application for reinstatement of
38 registration under this section is fifty dollars (\$50.00).

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

1 (e) Revocation of Registration. – If the Securities Division of the Department of
2 the Secretary of State finds that any of the information contained in an application of a
3 business registered under this section is false, it shall revoke the registration of the
4 business. The Secretary of State shall not revoke the registration of a business solely
5 because it ceases business operations for an indefinite period of time, as long as the
6 business renews its registration each year as required under this section.

7 (f) Transfer of Registration. – A registration as a qualified business may not be
8 sold or otherwise transferred, except that if a qualified business enters into a merger,
9 conversion, consolidation, or other similar transaction with another business and the
10 surviving company would otherwise meet the criteria for being a qualified business, the
11 surviving company retains the registration without further application to the Secretary
12 of State. In such a case, the qualified business must provide the Secretary of State with
13 written notice of the merger, conversion, consolidation, or similar transaction and the
14 name, address, and jurisdiction of incorporation or organization of the surviving
15 company.

16 (g) Report by Secretary of State. – The Secretary of State shall report to the
17 Revenue Laws Study Committee by October 1 of each year all of the businesses that
18 have registered with the Secretary of State as qualified business ventures, qualified
19 licensee businesses, and qualified grantee businesses. The report shall include the name
20 and address of each business, the location of its headquarters and principal place of
21 business, a detailed description of the types of business in which it engages, whether the
22 business is a minority business as defined in G.S. 143-128, the number of jobs created
23 by the business during the period covered by the report, and the average wages paid by
24 these jobs.

25 **"§ 105-163.010B. Sunset.**

26 This Part is repealed effective for investments made on or after January 1,
27 ~~2008~~2011.

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

29 **"§ 105-163.011. Tax credits allowed.**

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

34 (b) Individuals. – Subject to the limitations contained in G.S. 105-163.012, an
35 individual who purchases the equity securities or subordinated debt of a qualified
36 business directly from that business is allowed as a credit against the tax imposed by
37 Part 2 of this Article for the taxable year an amount equal to twenty-five percent (25%)
38 of the amount invested. 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). The
41 credit may not be taken for the year in which the investment is made but shall be taken
42 for the taxable year beginning during the calendar year in which the application for the
43 credit becomes effective as provided in subsection (c) of this section.

1 (b1) Pass-Through Entities. – This subsection does not apply to a pass-through
2 entity that has committed capital under management in excess of five million dollars
3 (\$5,000,000) or to a pass-through entity that is a qualified business or a North Carolina
4 Enterprise Corporation. Subject to the limitations provided in G.S. 105-163.012, a
5 pass-through entity that purchases the equity securities or subordinated debt of a
6 qualified business directly from the business is eligible for a tax credit equal to
7 twenty-five percent (25%) of the amount invested. The aggregate amount of credit
8 allowed a pass-through entity for one or more investments in a single taxable year under
9 this Part, whether directly or indirectly as owner of another pass-through entity, may not
10 exceed seven hundred fifty thousand dollars (\$750,000). The pass-through entity is not
11 eligible for the credit for the year in which the investment by the pass-through entity is
12 made but shall be eligible for the credit for the taxable year beginning during the
13 calendar year in which the application for the credit becomes effective as provided in
14 subsection (c) of this section.

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

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

24 (c) Application. – To be eligible for the tax credit provided in this section, the
25 taxpayer must file an application for the credit with the Secretary on or before April 15
26 of the year following the calendar year in which the investment was made. The
27 Secretary may grant extensions of this deadline, as the Secretary finds appropriate, upon
28 the request of the taxpayer, except that the application may not be filed after September
29 15 of the year following the calendar year in which the investment was made. An
30 application is effective for the year in which it is timely filed. The application shall be
31 on a form prescribed by the Secretary and shall include any supporting documentation
32 that the Secretary may require. If an investment for which a credit is applied for was
33 paid for other than in money, the taxpayer shall include with the application a certified
34 appraisal of the value of the property used to pay for the investment. The application for
35 a credit for an investment made by a pass-through entity must be filed by the
36 pass-through entity.

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

38 **"§ 105-163.012. (Repealed effective for investments made on or after January 1,**
39 **2008. See Editor's note) Limit; carry-over; ceiling; reduction in basis.**

40 (a) The credit allowed a taxpayer under G.S. 105-163.011 may not exceed the
41 amount of income tax imposed by Part 2 of this Article for the taxable year reduced by
42 the sum of all other credits allowable except tax payments made by or on behalf of the
43 taxpayer. The amount of unused credit allowed under G.S. 105-163.011 may be carried
44 forward for the next five succeeding years. The fifty thousand dollar (\$50,000)

1 limitation on the amount of credit allowed a taxpayer under G.S. 105-163.011 does not
2 apply to unused amounts carried forward under this subsection.

3 (b) The total amount of all tax credits allowed to taxpayers under
4 G.S. 105-163.011 for investments made in a calendar year may not exceed seven
5 million dollars (\$7,000,000). The Secretary of Revenue shall calculate the total amount
6 of tax credits claimed from the applications filed pursuant to G.S. 105-163.011(c). If the
7 total amount of tax credits claimed for investments made in a calendar year exceeds this
8 maximum amount, the Secretary shall allow a portion of the credits claimed by
9 allocating the maximum amount in tax credits in proportion to the size of the credit
10 claimed by each taxpayer.

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

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

22 **"§ 105-163.014. Forfeiture of credit.**

23 (a) Participation in Business. – A taxpayer who has received a credit under this
24 Part for an investment in a qualified business forfeits the credit if, within three years
25 after the investment was made, the taxpayer participates in the operation of the qualified
26 business. For the purpose of this section, a taxpayer participates in the operation of a
27 qualified business if the taxpayer, the taxpayer's spouse, parent, sibling, or child, or an
28 employee of any of these individuals or of a business controlled by any of these
29 individuals, provides services of any nature to the qualified business for compensation,
30 whether as an employee, a contractor, or otherwise. However, a person who provides
31 services to a qualified business, whether as an officer, a member of the board of
32 directors, or otherwise does not participate in its operation if the person receives as
33 compensation only reasonable reimbursement of expenses incurred in providing the
34 services, participation in a stock option or stock bonus plan, or both.

35 (b) False Application. – A taxpayer who has received a credit under this Part for
36 an investment in a qualified business forfeits the credit if the registration of the qualified
37 business is revoked because information in the registration application was false at the
38 time the application was filed with the Secretary of State.

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

40 (d) Transfer or Redemption of Investment. – A taxpayer who has received a
41 credit under this Part for an investment in a qualified business forfeits the credit in the
42 following cases:

- 43 (1) Within one year after the investment was made, the taxpayer transfers
44 any of the securities received in the investment that qualified for the

1 tax credit to another person or entity, other than in a transfer resulting
2 from one of the following:

- 3 a. The death of the taxpayer.
4 b. A final distribution in liquidation to the owners of a taxpayer
5 that is a corporation or other entity.
6 c. A merger, conversion, consolidation, or similar transaction
7 requiring approval by the owners of the qualified business
8 under applicable State law, to the extent the taxpayer does not
9 receive cash or tangible property in the merger, conversion,
10 consolidation, or other similar transaction.

- 11 (2) Except as provided in subsection (d1) of this section, within five years
12 after the investment was made, the qualified business in which the
13 investment was made makes a redemption with respect to the
14 securities received in the investment.

15 In the event the taxpayer transfers fewer than all the securities in a manner that
16 would result in a forfeiture, the amount of the credit that is forfeited is the product
17 obtained by multiplying the aggregate credit attributable to the investment by a fraction
18 whose numerator equals the number of securities transferred and whose denominator
19 equals the number of securities received on account of the investment to which the
20 credit was attributable. In addition, if the redemption amount is less than the amount
21 invested by the taxpayer in the securities to which the redemption is attributable, the
22 amount of the credit that is forfeited is further reduced by multiplying it by a fraction
23 whose numerator equals the redemption amount and whose denominator equals the
24 aggregate amount invested by the taxpayer in the securities involved in the redemption.
25 The term "redemption amount" means all amounts paid that are treated as a distribution
26 in part or full payment in exchange for securities under section 302(a) of the Code.

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

- 31 (1) The redemption occurred because the qualified business venture
32 completed production of a film, sold the film, and was liquidated.
33 (2) Neither the qualified business venture nor a related person continues to
34 engage in business with respect to the film produced by the qualified
35 business venture.

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

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

43 "**§ 105-163.020. Exclusion of gain allowed.**

1 (a) Election. – A taxpayer may elect to exclude from the taxpayer's income
2 taxable under this Article any gain or other taxable income recognized for federal
3 income tax purposes from the sale or exchange of qualified securities, not to exceed one
4 million dollars (\$1,000,000) for qualified securities in any single qualified business.

5 (b) Pass-Through Entity. – A taxpayer that is an owner of a pass-through entity
6 may exclude from the taxpayer's income taxable under this Article an amount equal to
7 the taxpayer's allocated share of the exclusion for which the pass-through entity is
8 eligible under subsection (a) of this section.

9 **"§ 105-163.021. Recapture of credit.**

10 If a taxpayer claims an exclusion of gain from income pursuant to G.S. 105-163.020,
11 the income tax of the taxpayer for the tax year for which the exclusion is claimed shall
12 be increased by the recapture amount. The recapture amount is the amount of all credits
13 previously claimed by the taxpayer pursuant to G.S. 105-163.011 with respect to
14 qualified securities that (i) have been sold or exchanged and (ii) the gain from which has
15 been excluded pursuant to G.S. 105-163.020. When the exclusion from gain has been
16 limited due to the dollar amount limitation in G.S. 105-163.020(a), the amount of the
17 recapture required under this credit shall be reduced. The amount of the recapture in this
18 case is equal to the recapture amount multiplied by a fraction. The numerator of the
19 fraction is the amount of the exclusion of gain allowed. The denominator of the fraction
20 is the amount of the exclusion of gain that would have been allowed without regard to
21 the dollar amount limitation in G.S. 105-163.020(a).

22 **"§ 105-163.022. Qualified securities.**

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

- 26 (1) It is originally issued by the business on or after January 1, 2008.
- 27 (2) As of the date of issuance, the issuing business is a qualified business.
- 28 (3) The security or instrument is acquired by the taxpayer at its original
29 issue in exchange for any tangible or intangible property or benefit to
30 the business, including cash, promissory notes, services performed,
31 contracts for services to be performed, or other equity securities of the
32 business.
- 33 (4) It is held by the taxpayer for a continuous period of more than one
34 year.
- 35 (5) No broker's fee or commission or other similar remuneration is paid or
36 given directly or indirectly for soliciting the purchase.
- 37 (6) If the security or instrument was purchased by a pass-through entity,
38 the entity met the requirements of G.S. 105-163.011(b1) at the time of
39 purchase.

40 (b) Registration. – Securities of a qualified business acquired before the effective
41 date of its registration are not qualified securities. Revocation of the registration of a
42 qualified business pursuant to G.S. 105-163.010A does not affect the exclusion of gain
43 from qualified securities acquired while the registration was in effect if all conditions
44 for registration are satisfied.

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

- 11 (1) Purchases, directly or indirectly, any of its outstanding equity
12 securities or subordinated debt, other than qualified securities, from the
13 taxpayer or a related person.
- 14 (2) Declares a dividend or makes a distribution with respect to any of its
15 outstanding equity securities or subordinated debt, other than qualified
16 securities, to the taxpayer or a related person. This subdivision does
17 not apply, however, to a distribution in connection with one of the
18 following:
- 19 a. The reimbursement to the taxpayer of the reasonable costs of
20 forming, syndicating, managing, and operating the business.
- 21 b. An increase in the taxpayer's taxes, penalties, or interest to the
22 extent the increase is caused by the allocation to the taxpayer of
23 income of the business.

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

31 (d) Exception for Certain Transactions. – The following transactions are not
32 treated as a redemption or distribution for the purposes of subsection (c) of this section:

- 33 (1) Any deemed liquidation of a business pursuant to section 708(b)(1)(A)
34 of the Code by reason of the business becoming a disregarded entity
35 for federal tax purposes, to the extent there is not actual distribution of
36 money or other property to the taxpayer of a related person.
- 37 (2) Any deemed distribution or redemption by reason of a technical
38 termination of a business pursuant to section 708(b)(1)(B) of the Code
39 to the extent there is no actual distribution of money or other property
40 to the taxpayer or a related person.

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

1 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
2 by the taxpayer on the date the taxpayer acquired the converted qualified security.

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

8 In the case of a transaction described in section 351 or 721 of the Code or a
9 reorganization described in section 368 of the Code, if qualified securities are
10 exchanged for other securities, the other securities are considered, for the purpose of
11 this section, qualified securities acquired on the date the exchanged qualified securities
12 were acquired. In the case of a transaction described in section 351 or 721 of the Code,
13 the newly acquired securities are considered qualified securities, however, only if,
14 immediately after the transaction, the business issuing the securities owns, directly or
15 indirectly, securities representing control, within the meaning of section 368(c) of the
16 Code, of the business whose securities were exchanged.

17 **"§ 105-163.023. Limitations.**

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

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

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

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

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

6 **(b) Transactions That Substantially Reduce the Risk of Loss.** – If a taxpayer has
7 entered into any transaction that substantially reduces the risk of loss from holding the
8 qualified securities, there is no exclusion of gain under this Part from the sale or
9 exchange of the qualified securities unless the taxpayer entered into the transaction 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 entered into that transaction. The
12 following are examples of a transaction that substantially reduces the risk of loss from
13 holding the qualified securities:

14 (1) The taxpayer or a related person has made a short sale of substantially
15 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 **SECTION 5.** This act is effective when it becomes law. Notwithstanding the
19 provisions of G.S. 105-163.010A as recodified by this act, if a qualified business files
20 its application for registration within 60 days after the effective date of this act and the
21 application is accepted, the effective date of the registration is the later of January 1,
22 2007, or the date the business first issues equity securities or subordinated debt.