

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2007

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HOUSE BILL 1771*

Short Title: Founders' Stock Tax Incentives. (Public)

Sponsors: Representatives T. Harrell, Jones (Primary Sponsors); Adams, Blue, Cotham, and Gibson.

Referred to: Science and Technology, if favorable, Finance.

April 19, 2007

A BILL TO BE ENTITLED

AN ACT TO EXCLUDE FROM INCOME TAX CERTAIN GAINS FROM INVESTMENTS IN TECHNOLOGY BUSINESSES AND OTHER QUALIFIED SMALL BUSINESSES.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-130.5(b) is amended by adding a new subdivision to read:

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

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

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

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

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

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

"Subpart 1. General Provisions.

§ 105-163.010. Definitions.

The following definitions apply in this Part:

- (1) Affiliate. – An individual or business that controls, is controlled by, or is under common control with another individual or business.
- (2) Business. – A corporation, partnership, limited liability company, association, or sole proprietorship operated for profit.
- (3) Control. – A person controls an entity if the person owns, directly or indirectly, more than ten percent (10%) of the voting securities of that

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

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

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

29 (5a) Granting entity. – Any of the following:

30 a. A domestic or foreign corporation that (i) is tax-exempt
31 pursuant to section 501(c)(3) of the Code, (ii) has as its
32 principal purpose the stimulation of the development of the
33 biotechnology industry, and (iii) in furtherance of that purpose
34 has received, or is a successor in interest to an organization that
35 has received, direct appropriations from the State in at least
36 three fiscal years.

37 b. A domestic or foreign corporation that meets the following
38 three conditions:

39 1. It is tax-exempt pursuant to section 501(c)(3) of the
40 Code, is a private foundation pursuant to section 509
41 of the Code, or is an affiliate of either of the foregoing.

42 2. It has as its principal purpose one of the following:
43 conducting research and development in, or stimulating
44 the development of, electronic, photonic, information, or

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

- 1 (9a) Qualified licensee business. – A business that meets all of the
2 following conditions:
- 3 a. It is registered with the Secretary of State under
4 G.S. 105-163.013;G.S. 105-163.010A.
- 5 b. During its most recent fiscal year before filing an application
6 for registration under G.S. 105-163.013;G.S. 105-163.010A, it
7 had gross revenues, as determined in accordance with generally
8 accepted accounting principles, of one million dollars
9 (\$1,000,000) or less on a consolidated basis.
- 10 c. It has been certified by a constituent institution of The
11 University of North Carolina or a research university as
12 currently performing under a licensing agreement with the
13 institution or university for the purpose of commercializing
14 technology developed at the institution or university. For the
15 purpose of this section, a research university is an institution of
16 higher education classified as a Doctoral/Research University,
17 Extensive or Intensive, in the most recent edition of 'A
18 Classification of Institutions of Higher Education', the official
19 report of The Carnegie Foundation for the Advancement of
20 Teaching.
- 21 (10) Real estate-related business. – A business that is involved in or related
22 to the brokerage, selling, purchasing, leasing, operating, or managing
23 of hotels, motels, nursing homes or other lodging facilities, golf
24 courses, sports or social clubs, restaurants, storage facilities, or
25 commercial or residential lots or buildings is a real estate-related
26 business, except that a real estate-related business does not include (i)
27 a business that purchases or leases real estate from others for the
28 purpose of providing itself with facilities from which to conduct a
29 business that is not itself a real estate-related business or (ii) a business
30 that is not otherwise a real estate-related business but that leases,
31 subleases, or otherwise provides to one or more other persons a
32 number of square feet of space which in the aggregate does not exceed
33 fifty percent (50%) of the number of square feet of space occupied by
34 the business for its other activities.
- 35 (10a) Related person. – A person described in one of the relationships set
36 forth in section 267(b) or 707(b) of the Code.
- 37 (11) Security. – A security as defined in Section 2(1) of the Securities Act
38 of 1933, 15 U.S.C. § 77b(1).
- 39 (12) ~~Selling or leasing at retail. – A business is selling or leasing at retail if~~
40 ~~the business either (i) sells or leases any product or~~Any of the
41 following:
- 42 a. Selling or leasing any service of any nature from a store or
43 other location open to the public generally or~~(ii) sells or leases~~
44 ~~products or generally.~~

- 1 (3) It is organized to engage primarily in manufacturing, processing,
2 warehousing, wholesaling, research and development, information
3 technology, or a service-related industry.
- 4 (4) It does not engage as a substantial part of its business in any of the
5 following:
- 6 a. Providing a professional service as defined in Chapter 55B of
7 the General Statutes.
- 8 b. Construction or contracting.
- 9 c. Selling or leasing at retail.
- 10 d. ~~The purchase, sale, or development, or purchasing,~~Purchasing,
11 developing, selling, or holding for investment of commercial
12 paper, notes, other indebtedness, financial instruments,
13 securities, or real property, or otherwise ~~make~~ making
14 investments.
- 15 e. Providing personal grooming or cosmetics services.
- 16 f. Offering any form of entertainment, amusement, recreation, or
17 athletic or fitness activity for which an admission or a
18 membership is charged.
- 19 (5) It was not formed for the primary purpose of acquiring all or part of
20 the ~~stock~~ stock, other ownership interest, or assets of one or more
21 existing businesses.
- 22 (6) It is not a real estate-related business.

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

30 To remain qualified as a qualified business venture, the business must renew its
31 registration annually as prescribed by rule by filing a financial statement for the most
32 recent fiscal year that is audited or reviewed by an independent certified public
33 accountant showing gross revenues, as determined in accordance with generally
34 accepted accounting principles, of five million dollars (\$5,000,000) or less on a
35 consolidated basis and an application for renewal in which the business certifies the
36 facts required in the original application.

37 Failure of a qualified business venture to renew its registration by the applicable
38 deadline ~~shall result~~ results in revocation of its registration effective as of the next day
39 after the renewal deadline, but ~~shall~~ does not result in forfeiture of tax credits previously
40 allowed to taxpayers who invested in the business except as provided in
41 G.S. 105-163.014. The Secretary of State shall send the qualified business venture
42 notice of revocation within 60 days after the renewal deadline. A qualified business
43 venture may apply to have its registration reinstated by the Secretary of State by filing
44 an application for reinstatement, accompanied by the reinstatement application fee and a

1 late filing penalty of one thousand dollars (\$1,000), within 30 days after receipt of the
2 revocation notice from the Secretary of State. A business that seeks approval of a new
3 application for registration after its registration has been revoked must also pay a
4 penalty of one thousand dollars (\$1,000). A registration that has been reinstated is
5 treated as if it had not been revoked.

6 If the gross revenues of a qualified business venture exceed five million dollars
7 (\$5,000,000) in a fiscal year, the business must notify the Secretary of State in writing
8 of this fact by filing a financial statement that is audited or reviewed by an independent
9 certified public accountant showing the revenues of the business for that year.

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

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

21 To remain qualified as a qualified licensee business, the business must renew its
22 registration annually as prescribed by rule by filing a financial statement for the most
23 recent fiscal year that is audited or reviewed by an independent certified public
24 accountant showing gross revenues, as determined in accordance with generally
25 accepted accounting principles, of one million dollars (\$1,000,000) or less on a
26 consolidated basis and an application for renewal in which the business certifies the
27 facts required in the original application.

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

41 If the gross revenues of a qualified licensee business ~~venture~~ exceed one million
42 dollars (\$1,000,000) in a fiscal year, the business must notify the Secretary of State in
43 writing of this fact by filing a financial statement that is audited or reviewed by an

1 independent certified public accountant showing the revenues of the business for that
2 year.

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

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

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

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

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

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

43 (e) Revocation of Registration. – If the Securities Division of the Department of
44 the Secretary of State finds that any of the information contained in an application of a

1 business registered under this section is false, it shall revoke the registration of the
2 business. The Secretary of State shall not revoke the registration of a business solely
3 because it ceases business operations for an indefinite period of time, as long as the
4 business renews its registration each year as required under this section.

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

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

23 **"§ 105-163.010B. Sunset.**

24 This Part is repealed effective for investments made on or after January 1,
25 ~~2008~~2011.

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

27 **"§ 105-163.011. Tax credits allowed.**

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

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

42 (b1) Pass-Through Entities. – This subsection does not apply to a pass-through
43 entity that has committed capital under management in excess of five million dollars
44 (\$5,000,000) or to a pass-through entity that is a qualified business or a North Carolina

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

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

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

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

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

35 **"§ 105-163.012. Limit; carry-over; ceiling; reduction in basis.**

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

43 (b) The total amount of all tax credits allowed to taxpayers under
44 G.S. 105-163.011 for investments made in a calendar year may not exceed seven

1 million dollars (\$7,000,000). The Secretary of Revenue shall calculate the total amount
2 of tax credits claimed from the applications filed pursuant to G.S. 105-163.011(c). If the
3 total amount of tax credits claimed for investments made in a calendar year exceeds this
4 maximum amount, the Secretary shall allow a portion of the credits claimed by
5 allocating the maximum amount in tax credits in proportion to the size of the credit
6 claimed by each taxpayer.

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

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

17 **"§ 105-163.014. Forfeiture of credit.**

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

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

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

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

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

42 a. The death of the taxpayer.

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

1 c. A merger, conversion, consolidation, or similar transaction
2 requiring approval by the owners of the qualified business
3 under applicable State law, to the extent the taxpayer does not
4 receive cash or tangible property in the merger, conversion,
5 consolidation, or other similar transaction.

6 (2) Except as provided in subsection (d1) of this section, within five years
7 after the investment was made, the qualified business in which the
8 investment was made makes a redemption with respect to the
9 securities received in the investment.

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

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

- 26 (1) The redemption occurred because the qualified business venture
27 completed production of a film, sold the film, and was liquidated.
28 (2) Neither the qualified business venture nor a related person continues to
29 engage in business with respect to the film produced by the qualified
30 business venture.

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

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

38 **"§ 105-163.020. Exclusion of gain allowed.**

39 (a) Any gain or other taxable income recognized for federal income tax purposes
40 from the sale or exchange of qualified securities is excluded from taxation under this
41 Article.

42 (b) A taxpayer that is an owner of a pass-through entity may exclude from the
43 taxpayer's income taxable under this Article an amount equal to the taxpayer's allocated

1 share of the exclusion for which the pass-through entity is eligible under subsection (a)
2 of this section.

3 **"§ 105-163.021. Qualified securities.**

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

7 (1) It is originally issued by the business on or after January 1, 2008.

8 (2) As of the date of issuance, the issuing business is a qualified business.

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

14 (4) It is held by the taxpayer for a continuous period of more than one
15 year.

16 (5) No broker's fee or commission or other similar remuneration is paid or
17 given directly or indirectly for soliciting the purchase.

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

23 (c) Effect of Redemptions and Other Distributions. – An equity security or
24 subordinated debt instrument is not a qualified security to the extent the taxpayer
25 purchased it with the proceeds of a redemption, dividend, or distribution made by the
26 business that issued the security or instrument. For the purpose of this subsection, when
27 a business makes a redemption, dividend, or distribution during the four-year period
28 beginning two years before the issuance of securities or instruments to a taxpayer, the
29 taxpayer is considered to have used the proceeds of the redemption, dividend, or
30 distribution toward the purchase of the securities or instruments. A redemption,
31 dividend, or distribution occurs when the business issuing the security or instrument
32 does either of the following:

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

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

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

1 b. An increase in the taxpayer's taxes, penalties, or interest to the
2 extent the increase is caused by the allocation to the taxpayer of
3 income of the business.

4 The repayment of principal on subordinated debt is a purchase of the debt except to
5 the extent the repayment is repayment of principal due on the subordinated debt at its
6 maturity pursuant to the terms of the subordinated debt instrument. If a transaction is
7 treated under section 304(a) of the Code as a distribution in redemption of the equity
8 securities of a business, that business has, for the purpose of this subsection, purchased
9 an amount of its equity securities equal to the amount treated as such a distribution
10 under section 304(a) of the Code.

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

13 (1) Any deemed liquidation of a business pursuant to section 708(b)(1)(A)
14 of the Code by reason of the business becoming a disregarded entity
15 for federal tax purposes, to the extent there is not actual distribution of
16 money or other property to the taxpayer of a related person.

17 (2) Any deemed distribution or redemption by reason of a technical
18 termination of a business pursuant to section 708(b)(1)(b) of the Code
19 to the extent there is no actual distribution of money or other property
20 to the taxpayer or a related person.

21 (e) Conversion of Other Securities. – Any equity security or subordinated debt
22 instrument issued by a business and acquired by the taxpayer solely through the
23 conversion of another equity security or subordinated debt instrument that was issued by
24 the business and was a qualified security in the hands of the taxpayer is considered, for
25 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
26 by the taxpayer on the date the taxpayer acquired the converted qualified security.

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

32 In the case of a transaction described in section 351 or 721 of the Code or a
33 reorganization described in section 368 of the Code, if qualified securities are
34 exchanged for other securities, the other securities are considered, for the purpose of
35 this section, qualified securities acquired on the date the exchanged qualified securities
36 were acquired. In the case of a transaction described in section 351 or 721 of the Code,
37 the newly acquired securities are considered qualified securities, however, only if,
38 immediately after the transaction, the business issuing the securities owns, directly or
39 indirectly, securities representing control, within the meaning of section 368(c) of the
40 Code, of the business whose securities were exchanged.

41 **"§ 105-163.022. Limitations.**

42 (a) Contributions and Exchanges of Property. – In the case of a transaction
43 described in section 351 or 721 of the Code or a reorganization described in section 368

1 of the Code, if a taxpayer contributes property to or exchanges property with a qualified
2 business, the following rules apply:

3 (1) Qualified securities exchanged for property. – Except as otherwise
4 provided in subdivision (3) of this subsection, a taxpayer who transfers
5 property to a business in exchange for qualified securities in the
6 business must, for purposes of determining North Carolina taxable
7 income, recognize gain equal to the amount by which the fair market
8 value of the property exceeded the taxpayer's basis in the property on
9 the date the property was exchanged for the qualified securities. This
10 gain must be recognized for the years for which the taxpayer claims an
11 exclusion of gain under this Part with respect to the disposition of
12 qualified securities received in exchange for the property.

13 (2) Contributions to capital. – Except as otherwise provided in subdivision
14 (3) of this subsection, if the adjusted basis of a qualified security is
15 adjusted due to a contribution to capital after the date the qualified
16 security was issued originally, for purposes of determining North
17 Carolina taxable income, the taxpayer must recognize gain equal to the
18 amount by which the fair market value of the contributed property
19 exceeded the taxpayer's basis in the property on the date the property
20 was contributed. This gain must be recognized for the years for which
21 the taxpayer claims an exclusion of gain under this Part with respect to
22 the disposition of the qualified securities.

23 (3) Disposition of contributed property. – If a qualified business disposes
24 of property contributed to it, the disposition occurs before the taxpayer
25 who contributed the property claims an exclusion of gain pursuant to
26 this Part with respect to qualified securities affected by the
27 contribution, and the taxpayer recognizes gain from the disposition,
28 then for purposes of subdivisions (1) and (2) of this subsection, the
29 taxpayer's basis in the contributed property is increased by any gain
30 the taxpayer recognized from the disposition.

31 (b) Transactions That Substantially Reduce the Risk of Loss. – If a taxpayer has
32 entered into any transaction that substantially reduces the risk of loss from holding the
33 qualified securities, there is no exclusion of gain under this Part from the sale or
34 exchange of the qualified securities unless the taxpayer entered into the transaction on
35 or after January 1, 2009, and elects to recognize gain as if the qualified securities were
36 sold at fair market value on the date the taxpayer first entered into that transaction. The
37 following are examples of a transaction that substantially reduces the risk of loss from
38 holding the qualified securities:

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

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

43 **SECTION 5.** This act is effective when it becomes law. Notwithstanding the
44 provisions of G.S. 105-163.010A as recodified by this act, if a qualified business files

- 1 its application for registration within 60 days after the effective date of this act and the
- 2 application is accepted, the effective date of the registration is the later of January 1,
- 3 2007, or the date the business first issues equity securities or subordinated debt.