

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2007

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HOUSE DRH10108-LY-211 (3/23)

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

Sponsors: Representatives Gibson and Ross (Primary Sponsors).

Referred to:

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. 150-130.5(b) is amended by adding a new subdivision to
read:

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

...

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

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

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

...

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

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.

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

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

4 "Subpart 1. General Provisions.

5 **"§ 105-163.010. Definitions.**

6 The following definitions apply in this Part:

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

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

- 1 (9) Qualified grantee business. – A business that (i) is registered with the
2 Secretary of State under G.S. ~~405-163.013~~,105-163.010A and (ii) has
3 received during the current year or any of the preceding three years a
4 grant, an investment, or other funding from a federal agency under the
5 Small Business Innovation Research Program administered by the
6 United States Small Business Administration or from a granting entity
7 as defined in this section.
- 8 (9a) Qualified licensee business. – A business that meets all of the
9 following conditions:
- 10 a. It is registered with the Secretary of State under
11 G.S. ~~405-163.013~~,105-163.010A.
- 12 b. During its most recent fiscal year before filing an application
13 for registration under G.S. ~~405-163.013~~,105-163.010A, it had
14 gross revenues, as determined in accordance with generally
15 accepted accounting principles, of one million dollars
16 (\$1,000,000) or less on a consolidated basis.
- 17 c. It has been certified by a constituent institution of The
18 University of North Carolina or a research university as
19 currently performing under a licensing agreement with the
20 institution or university for the purpose of commercializing
21 technology developed at the institution or university. For the
22 purpose of this section, a research university is an institution of
23 higher education classified as a Doctoral/Research University,
24 Extensive or Intensive, in the most recent edition of "A
25 Classification of Institutions of Higher Education", the official
26 report of The Carnegie Foundation for the Advancement of
27 Teaching.
- 28 (10) Real estate-related business. – A business that is involved in or related
29 to the brokerage, selling, purchasing, leasing, operating, or managing
30 of hotels, motels, nursing homes or other lodging facilities, golf
31 courses, sports or social clubs, restaurants, storage facilities, or
32 commercial or residential lots or buildings is a real estate-related
33 business, except that a real estate-related business does not include (i)
34 a business that purchases or leases real estate from others for the
35 purpose of providing itself with facilities from which to conduct a
36 business that is not itself a real estate-related business or (ii) a business
37 that is not otherwise a real estate-related business but that leases,
38 subleases, or otherwise provides to one or more other persons a
39 number of square feet of space which in the aggregate does not exceed
40 fifty percent (50%) of the number of square feet of space occupied by
41 the business for its other activities.
- 42 (10a) Related person. – A person described in one of the relationships set
43 forth in section 267(b) or 707(b) of the Code.

- 1 (11) Security. – A security as defined in Section 2(1) of the Securities Act
2 of 1933, 15 U.S.C. § 77b(1).
- 3 (12) Selling or leasing at retail. – ~~A business is selling or leasing at retail if~~
4 ~~the business either (i) sells or leases any product or~~ Any of the
5 following:
- 6 a. Selling or leasing any service of any nature from a store or
7 other location open to the public ~~generally or (ii) sells or leases~~
8 ~~products or generally.~~
- 9 b. Selling or leasing services of any nature by means other than to
10 or through one or more other businesses.
- 11 c. Reselling or leasing at retail products that are purchased or
12 leased at wholesale and then resold or leased substantially
13 unmodified.
- 14 (13) Service-related industry. – A business is engaged in a service-related
15 industry, whether or not it also sells a product, if it provides services to
16 customers or clients and does not as a substantial part of its business
17 engage in a business described in
18 G.S. ~~105-163.013(b)(4); 105-163.010A(b)(4)~~. A business is engaged as
19 a substantial part of its business in an activity described in
20 G.S. ~~105-163.013(b)(4); 105-163.010A(b)(4)~~ if (i) its gross revenues
21 derived from all activities described in that subdivision exceed
22 twenty-five percent (25%) of its gross revenues in any fiscal year or
23 (ii) it is established as one of its primary purposes to engage in any
24 activities described in that subdivision, whether or not its purposes
25 were stated in its articles of incorporation or similar organization
26 documents.
- 27 (14) Subordinated debt. – Indebtedness that is not secured and is
28 subordinated to all other indebtedness of the issuer issued or to be
29 issued to a financial institution other than a financial institution
30 described in subdivisions (5)(ii) through (5)(v) of this section. ~~Except~~
31 For the purposes of Subpart 2 of this Part only, except as provided in
32 G.S. 105-163.014(d1), any portion of indebtedness that matures earlier
33 than five years after its issuance is not subordinated debt.

34 **"§ 105-163.010A. Registration.**

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

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

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

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

30 The effective date of registration for a qualified business venture whose application

31 is accepted for registration is 60 days before the date its application is filed. No credit or

32 exclusion of gain is allowed under this Part for an investment made before the effective

33 date of the registration or after the registration is revoked. For the purpose of this

34 Article, if a taxpayer's investment is placed initially in escrow conditioned upon other

35 investors' commitment of additional funds, the date of the investment is the date

36 escrowed funds are transferred to the qualified business venture free of the condition.

37 To remain qualified as a qualified business venture, the business must renew its

38 registration annually as prescribed by rule by filing a financial statement for the most

39 recent fiscal year showing gross revenues, as determined in accordance with generally

40 accepted accounting principles, of five million dollars (\$5,000,000) or less on a

41 consolidated basis and an application for renewal in which the business certifies the

42 facts required in the original application.

43 Failure of a qualified business venture to renew its registration by the applicable

44 deadline ~~shall result~~results in revocation of its registration effective as of the next day

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

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

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

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

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

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

1 penalty of one thousand dollars (\$1,000). A registration that has been reinstated is
2 treated as if it had not been revoked.

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

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

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

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

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

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

41 An application for renewal of registration under this section must indicate whether
42 the applicant is a minority business, as defined in G.S. 143-128, and include a report of
43 the number of jobs the business created during the preceding year that are attributable to
44 investments that qualify under this section for a tax credit and the average wages paid

1 by each job. An application that does not contain this information is incomplete and the
2 applicant's registration may not be renewed until the information is provided.

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

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

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

27 **"§ 105-163.010B. Sunset.**

28 This Part is repealed effective for investments made on or after January 1,
29 ~~2008-2011.~~

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

31 **"§ 105-163.011. Tax credits allowed.**

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

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

1 for the taxable year beginning during the calendar year in which the application for the
2 credit becomes effective as provided in subsection (c) of this section.

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

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

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

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

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

40 **"§ 105-163.012. (Repealed effective for investments made on or after January 1,
41 2008. See Editor's note) Limit; carry-over; ceiling; reduction in basis.**

42 (a) The credit allowed a taxpayer under G.S. 105-163.011 may not exceed the
43 amount of income tax imposed by Part 2 of this Article for the taxable year reduced by
44 the sum of all other credits allowable except tax payments made by or on behalf of the

1 taxpayer. The amount of unused credit allowed under G.S. 105-163.011 may be carried
2 forward for the next five succeeding years. The fifty thousand dollar (\$50,000)
3 limitation on the amount of credit allowed a taxpayer under G.S. 105-163.011 does not
4 apply to unused amounts carried forward under this subsection.

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

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

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

24 **"§ 105-163.014. Forfeiture of credit.**

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

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

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

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

- 1 (1) Within one year after the investment was made, the taxpayer transfers
2 any of the securities received in the investment that qualified for the
3 tax credit to another person or entity, other than in a transfer resulting
4 from one of the following:
- 5 a. The death of the taxpayer.
 - 6 b. A final distribution in liquidation to the owners of a taxpayer
7 that is a corporation or other entity.
 - 8 c. A merger, conversion, consolidation, or similar transaction
9 requiring approval by the owners of the qualified business
10 under applicable State law, to the extent the taxpayer does not
11 receive cash or tangible property in the merger, conversion,
12 consolidation, or other similar transaction.
- 13 (2) Except as provided in subsection (d1) of this section, within five years
14 after the investment was made, the qualified business in which the
15 investment was made makes a redemption with respect to the
16 securities received in the investment.

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

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

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

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

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

1 **"§ 105-163.020. Exclusion of gain allowed.**

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

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

10 **"§ 105-163.021. Recapture of credit.**

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

23 **"§ 105-163.022. Qualified securities.**

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

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

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

1 from qualified securities acquired while the registration was in effect if all conditions
2 for registration are satisfied.

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

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

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

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

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

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

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

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

39 (2) Any deemed distribution or redemption by reason of a technical
40 termination of a business pursuant to section 708(b)(1)(B) of the Code
41 to the extent there is no actual distribution of money or other property
42 to the taxpayer or a related person.

43 (e) Conversion of Other Securities. – Any equity security or subordinated debt
44 instrument issued by a business and acquired by the taxpayer solely through the

1 conversion of another equity security or subordinated debt instrument that was issued by
2 the business and was a qualified security in the hands of the taxpayer is considered, for
3 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
4 by the taxpayer on the date the taxpayer acquired the converted qualified security.

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

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

19 **"§ 105-163.023. Limitations.**

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

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

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

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

9 (b) Transactions That Substantially Reduce the Risk of Loss. – If a taxpayer has
10 entered into any transaction that substantially reduces the risk of loss from holding the
11 qualified securities, there is no exclusion of gain under this Part from the sale or
12 exchange of the qualified securities unless the taxpayer entered into the transaction on
13 or after January 1, 2008, and elects to recognize gain as if the qualified securities were
14 sold at fair market value on the date the taxpayer first entered into that transaction. The
15 following are examples of a transaction that substantially reduces the risk of loss from
16 holding the qualified securities:

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

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

21 **SECTION 5.** This act is effective when it becomes law. Notwithstanding the
22 provisions of G.S. 105-163.010A as recodified by this act, if a qualified business files
23 its application for registration within 60 days after the effective date of this act and the
24 application is accepted, the effective date of the registration is the later of January 1,
25 2007, or the date the business first issues equity securities or subordinated debt.