

**GENERAL ASSEMBLY OF NORTH CAROLINA**  
**SESSION 2005**

**H**

**D**

**HOUSE DRH80377-LYx-249 (4/27)**

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

---

Sponsors: Representatives Gibson and Daughtridge (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. 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.

- 1           (3) Control. – A person controls an entity if the person owns, directly or  
2 indirectly, more than ten percent (10%) of the voting securities of that  
3 entity. As used in this subdivision, the term 'voting security' means a  
4 security that (i) confers upon the holder the right to vote for the  
5 election of members of the board of directors or similar governing  
6 body of the business or (ii) is convertible into, or entitles the holder to  
7 receive upon its exercise, a security that confers such a right to vote. A  
8 general partnership interest is a voting security.
- 9           (4) Equity security. – Common stock, preferred stock, or an interest in a  
10 ~~partnership, partnership or limited liability company~~, or subordinated  
11 debt that is convertible into, or entitles the holder to receive upon its  
12 exercise, common stock, preferred stock, or an interest in a  
13 ~~partnership, partnership or limited liability company~~.
- 14           (5) Financial institution. – A business that is (i) a bank holding company,  
15 as defined in the Bank Holding Company Act of 1956, 12 U.S.C. §§  
16 1841, et seq., or its wholly owned subsidiary, (ii) registered as a  
17 broker-dealer under the Securities Exchange Act of 1934, 15 U.S.C. §§  
18 78a, et seq., or its wholly owned subsidiary, (iii) an investment  
19 company as defined in the Investment Company Act of 1940, 15  
20 U.S.C. §§ 80a-1, et seq., whether or not it is required to register under  
21 that act, (iv) a small business investment company as defined in the  
22 Small Business Investment Act of 1958, 15 U.S.C. §§ 661, et seq., (v)  
23 a pension or profit-sharing fund or trust, or (vi) a bank, savings  
24 institution, trust company, financial services company, or insurance  
25 company. The term does not include, however, a business, other than a  
26 small business investment company, whose net worth, when added to  
27 the net worth of all of its affiliates, is less than ten million dollars  
28 (\$10,000,000). The term also does not include a business that does not  
29 generally market its services to the public and is controlled by a  
30 business that is not a financial institution.
- 31           (5a) Granting entity. – Any of the following:
- 32           a. A domestic or foreign corporation that (i) is tax-exempt  
33 pursuant to section 501(c)(3) of the Code, (ii) has as its  
34 principal purpose the stimulation of the development of the  
35 biotechnology industry, and (iii) in furtherance of that purpose  
36 has received, or is a successor in interest to an organization that  
37 has received, direct appropriations from the State in at least  
38 three fiscal years.
- 39           b. A domestic or foreign corporation that meets the following  
40 three conditions:
- 41           1. It is tax-exempt pursuant to section 501(c)(3) of the  
42 Code, is a private foundation pursuant to section 509  
43 of the Code, or is an affiliate of either of the foregoing.

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

1 under the Small Business Innovation Research Program administered  
2 by the United States Small Business Administration or from a granting  
3 entity as defined in this section.

4 (9a) Qualified licensee business. – A business that meets all of the  
5 following conditions:

6 a. It is registered with the Secretary of State under  
7 ~~G.S. 105-163.013~~G.S. 105-163.010A.

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

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

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

38 (10a) Related person. – A person described in one of the relationships set  
39 forth in section 267(b) or 707(b) of the Code.

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

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

- 1           a.     Selling or leasing any service of any nature from a store or  
2                     other location open to the public ~~generally or (ii) sells or leases~~  
3                     ~~products or generally.~~  
4           b.     Selling or leasing services of any nature by means other than to  
5                     or through one or more other businesses.  
6           c.     Reselling or leasing at retail products that are purchased or  
7                     leased at wholesale and then resold or leased substantially  
8                     unmodified.

9           (13) Service-related industry. – A business is engaged in a service-related  
10                    industry, whether or not it also sells a product, if it provides services to  
11                    customers or clients and does not as a substantial part of its business  
12                    engage in a business described in ~~G.S. 105-163.013(b)(4)~~ G.S.  
13                    105-163.010A(b)(4). A business is engaged as a substantial part of its  
14                    business in an activity described in ~~G.S. 105-163.013(b)(4)~~ G.S.  
15                    105-163.010A(b)(4) if (i) its gross revenues derived from all activities  
16                    described in that subdivision exceed twenty-five percent (25%) of its  
17                    gross revenues in any fiscal year or (ii) it is established as one of its  
18                    primary purposes to engage in any activities described in that  
19                    subdivision, whether or not its purposes were stated in its articles of  
20                    incorporation or similar organization documents.

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

28   "**§ 105-163.010A. Registration.**

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

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

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

39           (1a) Reserved for future codification purposes.

40           (1b) Either (i) it was organized after January 1 of the calendar year in which  
41                    its application is filed or (ii) during its most recent fiscal year before  
42                    filing the application, it had gross revenues, as determined in  
43                    accordance with generally accepted accounting principles, of five  
44                    million dollars (\$5,000,000) or less on a consolidated basis.

- 1 (2) Repealed by Session Laws 1996, Second Extra Session, c. 14, s. 7.  
2 (3) It is organized to engage primarily in manufacturing, processing,  
3 warehousing, wholesaling, research and development, information  
4 technology, or a service-related industry.  
5 (4) It does not engage as a substantial part of its business in any of the  
6 following:  
7 a. Providing a professional service as defined in Chapter 55B of  
8 the General Statutes.  
9 b. Construction or contracting.  
10 c. Selling or leasing at retail.  
11 d. ~~The purchase, sale, or development, or purchasing,~~Purchasing,  
12 developing, selling, or holding for investment of commercial  
13 paper, notes, other indebtedness, financial instruments,  
14 securities, or real property, or otherwise ~~make~~making  
15 investments.  
16 e. Providing personal grooming or cosmetics services.  
17 f. Offering any form of entertainment, amusement, recreation, or  
18 athletic or fitness activity for which an admission or a  
19 membership is charged.  
20 (5) It was not formed for the primary purpose of acquiring all or part of  
21 the ~~stock~~stock, other ownership interest, or assets of one or more  
22 existing businesses.  
23 (6) It is not a real estate-related business.

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

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

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

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

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

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

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

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

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

42 If the gross revenues of a qualified licensee business ~~venture~~ exceed one million  
43 dollars (\$1,000,000) in a fiscal year, the business must notify the Secretary of State in  
44 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, 2008.

25 **"Subpart 2. Tax Credits for Qualified Business Investments.**

26 **"§ 105-163.011. Tax credits allowed.**

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

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

41 (b1) Pass-Through Entities. – This subsection does not apply to a pass-through  
42 entity that has committed capital under management in excess of five million dollars  
43 (\$5,000,000) or to a pass-through entity that is a qualified business or a North Carolina  
44 Enterprise Corporation. Subject to the limitations provided in G.S. 105-163.012, a

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

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

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

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

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

34 **"§ 105-163.012. Limit; carry-over; ceiling; reduction in basis.**

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

42 (b) The total amount of all tax credits allowed to taxpayers under  
43 G.S. 105-163.011 for investments made in a calendar year may not exceed seven  
44 million dollars (\$7,000,000). The Secretary of Revenue shall calculate the total amount

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

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

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

16 **"§ 105-163.014. Forfeiture of credit.**

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

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

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

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

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

41 a. The death of the taxpayer.

42 b. A final distribution in liquidation to the owners of a taxpayer  
43 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, 2006.

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, 2007, 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 2005, or the date the business first issues equity securities or subordinated debt.