

**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2005**

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SENATE BILL 905

Short Title: Founder's Stock Tax Incentives. (Public)

Sponsors: Senators Cowell; Bingham, Boseman, Graham, Hagan, Hartsell, and
Malone.

Referred to: Finance.

March 23, 2005

A BILL TO BE ENTITLED

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

The General Assembly of North Carolina enacts:

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

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

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

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

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

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

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

"Subpart 1. General Provisions.

§ 105-163.010. Definitions.

The following definitions apply in this Part:

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

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

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

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

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

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

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

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

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

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

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

- 1 b. Selling or leasing services of any nature by means other than to
2 or through one or more other businesses.
3 c. Reselling or leasing at retail products that are purchased or
4 leased at wholesale and then resold or leased substantially
5 unmodified.

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

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

25 **"§ 105-163.010A. Registration.**

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

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

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

36 (1a) Reserved for future codification purposes.

37 (1b) Either (i) it was organized after January 1 of the calendar year in which
38 its application is filed or (ii) during its most recent fiscal year before
39 filing the application, it had gross revenues, as determined in
40 accordance with generally accepted accounting principles, of five
41 million dollars (\$5,000,000) or less on a consolidated basis.

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

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

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

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

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

1 application for registration after its registration has been revoked must also pay a
2 penalty of one thousand dollars (\$1,000). A registration that has been reinstated is
3 treated as if it had not been revoked.

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

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

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

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

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

38 If the gross revenues of a qualified business venture exceed one million dollars
39 (\$1,000,000) in a fiscal year, the business must notify the Secretary of State in writing
40 of this fact by filing a financial statement showing the revenues of the business for that
41 year.

42 (c) Qualified Grantee Businesses. – In order to qualify as a qualified grantee
43 business under this Part, a business must be registered with the Securities Division of
44 the Department of the Secretary of State. To register, the business must file with the

1 Secretary of State an application and any supporting documents the Secretary of State
2 may require from time to time to determine that the business meets the requirements for
3 registration as a qualified grantee business. The requirements for registration as a
4 qualified grantee business are set out in G.S. 105-163.010.

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

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

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

28 The fee for filing an application for registration under this section is one hundred
29 dollars (\$100.00). The fee for filing an application for renewal of registration under this
30 section is fifty dollars (\$50.00). The fee for filing an application for reinstatement of
31 registration under this section is fifty dollars (\$50.00).

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

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

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

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

19 **"§ 105-163.010B. Sunset.**

20 This Part is repealed effective for investments made on or after January 1, 2008.

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

22 **"§ 105-163.011. Tax credits allowed.**

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

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

37 (b1) Pass-Through Entities. – This subsection does not apply to a pass-through
38 entity that has committed capital under management in excess of five million dollars
39 (\$5,000,000) or to a pass-through entity that is a qualified business or a North Carolina
40 Enterprise Corporation. Subject to the limitations provided in G.S. 105-163.012, a
41 pass-through entity that purchases the equity securities or subordinated debt of a
42 qualified business directly from the business is eligible for a tax credit equal to
43 twenty-five percent (25%) of the amount invested. The aggregate amount of credit
44 allowed a pass-through entity for one or more investments in a single taxable year under

1 this Part, whether directly or indirectly as owner of another pass-through entity, may not
2 exceed seven hundred fifty thousand dollars (\$750,000). The pass-through entity is not
3 eligible for the credit for the year in which the investment by the pass-through entity is
4 made but shall be eligible for the credit for the taxable year beginning during the
5 calendar year in which the application for the credit becomes effective as provided in
6 subsection (c) of this section.

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

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

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

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

30 **"§ 105-163.012. Limit; carry-over; ceiling; reduction in basis.**

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

38 (b) The total amount of all tax credits allowed to taxpayers under
39 G.S. 105-163.011 for investments made in a calendar year may not exceed seven
40 million dollars (\$7,000,000). The Secretary of Revenue shall calculate the total amount
41 of tax credits claimed from the applications filed pursuant to G.S. 105-163.011(c). If the
42 total amount of tax credits claimed for investments made in a calendar year exceeds this
43 maximum amount, the Secretary shall allow a portion of the credits claimed by

1 allocating the maximum amount in tax credits in proportion to the size of the credit
2 claimed by each taxpayer.

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

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

13 **"§ 105-163.014. Forfeiture of credit.**

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

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

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

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

- 34 (1) Within one year after the investment was made, the taxpayer transfers
35 any of the securities received in the investment that qualified for the
36 tax credit to another person or entity, other than in a transfer resulting
37 from one of the following:
- 38 a. The death of the taxpayer.
 - 39 b. A final distribution in liquidation to the owners of a taxpayer
40 that is a corporation or other entity.
 - 41 c. A merger, conversion, consolidation, or similar transaction
42 requiring approval by the owners of the qualified business
43 under applicable State law, to the extent the taxpayer does not

1 receive cash or tangible property in the merger, conversion,
2 consolidation, or other similar transaction.

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

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

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

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

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

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

35 **"§ 105-163.020. Exclusion of gain allowed.**

36 (a) Any gain recognized for federal income tax purposes from the sale or
37 exchange of qualified securities is excluded from taxation under this Article.

38 (b) A taxpayer that is an owner of a pass-through entity may exclude from the
39 taxpayer's income taxable under this Article an amount equal to the taxpayer's allocated
40 share of the exclusion for which the pass-through entity is eligible under subsection (a)
41 of this section.

42 **"§ 105-163.021. Qualified securities.**

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

4 (1) It is originally issued by the business on or after January 1, 2005.

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

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

11 (4) It is held by the taxpayer for a continuous period of at least one year.

12 (b) Registration. – Securities of a qualified business acquired more than 60 days
13 before the effective date of its registration are not qualified securities. Revocation of the
14 registration of a qualified business pursuant to G.S. 105-163.010A does not affect the
15 exclusion of gain from qualified securities acquired while the registration was in effect
16 or within 60 days before it became effective.

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

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

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

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

37 b. An increase in the taxpayer's taxes, penalties, or interest to the
38 extent the increase is caused by the allocation to the taxpayer of
39 income of the business.

40 The repayment of principal on subordinated debt is a purchase of the debt except to
41 the extent the repayment is repayment of principal due on the subordinated debt at its
42 maturity pursuant to the terms of the subordinated debt instrument. If a transaction is
43 treated under section 304(a) of the Code as a distribution in redemption of the equity
44 securities of a business, that business has, for the purpose of this subsection, purchased

1 an amount of its equity securities equal to the amount treated as such a distribution
2 under section 304(a) of the Code.

3 (d) Conversion of Other Securities. – Any equity security or subordinated debt
4 instrument issued by a business and acquired by the taxpayer solely through the
5 conversion of another equity security or subordinated debt instrument that was issued by
6 the business and was a qualified security in the hands of the taxpayer is considered, for
7 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
8 by the taxpayer on the date the taxpayer acquired the converted qualified security.

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

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

23 **"§ 105-163.022. Limitations.**

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

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

38 (2) Contributions to capital. – Except as otherwise provided in subdivision
39 (3) of this subsection, if the adjusted basis of a qualified security is
40 adjusted due to a contribution to capital after the date the qualified
41 security was issued originally, for purposes of determining North
42 Carolina taxable income, the taxpayer must recognize gain equal to the
43 amount by which the fair market value of the contributed property
44 exceeded the taxpayer's basis in the property on the date the property

1 was contributed. This gain must be recognized for the years for which
2 the taxpayer claims an exclusion of gain under this Part with respect to
3 the disposition of the qualified securities.

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

12 (b) Short Positions. – If a taxpayer has an offsetting short position with respect to
13 any qualified securities, there is no exclusion of gain under this Part from the sale or
14 exchange of the qualified securities unless the taxpayer established the short position on
15 or after January 1, 2006, and elects to recognize gain as if the qualified securities were
16 sold at fair market value on the date the taxpayer first established the short position. For
17 the purposes of this subsection, a taxpayer has an offsetting short position with respect
18 to qualified securities if one of the following conditions is satisfied:

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

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

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

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

35 **SECTION 5.** This act is effective when it becomes law. Notwithstanding the
36 provisions of G.S. 105-163.010A as recodified by this act, if a qualified business files
37 its application for registration within 60 days after the effective date of this act and the
38 application is accepted, the effective date of the registration is the later of January 1,
39 2005, or the date the business first issues equity securities or subordinated debt.