

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

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HOUSE DRH10616-MC-151* (3/11)

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

Sponsors: Representative Gibson.

Referred to:

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

4 The General Assembly of North Carolina enacts:

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

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

8 ...

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

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

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

17 ...

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

22 **SECTION 3.** Part 5 of Article 4 of Chapter 105 of the General Statutes is amended
23 to add the following sections:

24 "**§ 105-163.020. Exclusion of gain allowed.**

25 (a) Election. – A taxpayer may elect to exclude from the taxpayer's income taxable
26 under this Article any gain or other taxable income recognized for federal income tax purposes
27 from the sale or exchange of qualified securities.

28 (b) Pass-Through Entity. – Except as provided in subsection (c) of this section, a
29 taxpayer who is an owner of a pass-through entity may exclude from the taxpayer's income
30 taxable under this Article an amount equal to the taxpayer's allocated share of the exclusion for
31 which the pass-through entity is eligible under subsection (a) of this section.

32 (c) Qualified Grantee Pass-Through Entity. – If a taxpayer is an owner of a
33 pass-through entity that was a qualified grantee business at the time of the taxpayer's
34 investment in the pass-through entity, the taxpayer may exclude from the taxpayer's income
35 taxable under this Article an amount equal to the gain or other taxable income recognized as a



1 result of the taxpayer's ownership in the pass-through entity, multiplied by a fraction, the
2 numerator of which is the total amount invested by the pass-through entity in qualified
3 businesses and the denominator of which is the total amount invested by the pass-through
4 entity. For purposes of this subsection, the amounts invested by a pass-through entity shall be
5 the maximum amounts actually invested at any time prior to the pass-through entity's sale or
6 exchange producing the gain or taxable income excluded under this subsection, determined
7 without regard to any positive or negative returns on investment.

8 **"§ 105-163.021. Recapture of credit.**

9 If a taxpayer claims an exclusion of gain from income pursuant to G.S. 105-163.020, the
10 income tax of the taxpayer for the tax year for which the exclusion is claimed shall be increased
11 by the amount of all credits previously claimed by the taxpayer pursuant to G.S. 105-163.011
12 with respect to qualified securities that (i) have been sold or exchanged and (ii) the gain from
13 which has been excluded pursuant to G.S. 105-163-020.

14 **"§ 105-163.022. Qualified securities.**

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

- 18 (1) It is originally issued by the business on or after January 1, 2010.
- 19 (2) As of the date of issuance, the issuing business is a qualified business.
- 20 (3) The security or instrument is acquired by the taxpayer at its original issue in
21 exchange for any tangible or intangible property or benefit to the business,
22 including cash, promissory notes, services performed, contracts for services
23 to be performed, or other equity securities of the business.
- 24 (4) It is held by the taxpayer for a continuous period of more than one year.
- 25 (5) No broker's fee or commission or other similar remuneration is paid or given
26 directly or indirectly for soliciting the purchase.
- 27 (6) If the security or instrument was purchased by a pass-through entity, the
28 entity met the requirements of G.S. 105-163.011(b1) at the time of purchase.

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

34 (c) Effect of Redemptions and Other Distributions. – An equity security or subordinated
35 debt instrument is not a qualified security to the extent the taxpayer purchased it with the
36 proceeds of a redemption, dividend, or distribution made by the business that issued the
37 security or instrument. For the purpose of this subsection, when a business makes a redemption,
38 dividend, or distribution during the four-year period beginning two years before the issuance of
39 securities or instruments to a taxpayer, the taxpayer is considered to have used the proceeds of
40 the redemption, dividend, or distribution toward the purchase of the securities or instruments. A
41 redemption, dividend, or distribution occurs when the business issuing the security or
42 instrument does either of the following:

- 43 (1) Purchases, directly or indirectly, any of its outstanding equity securities or
44 subordinated debt, other than qualified securities, from the taxpayer or a
45 related person.
- 46 (2) Declares a dividend or makes a distribution with respect to any of its
47 outstanding equity securities or subordinated debt, other than qualified
48 securities, to the taxpayer or a related person. This subdivision does not
49 apply, however, to a distribution in connection with one of the following:
 - 50 a. The reimbursement to the taxpayer of the reasonable costs of
51 forming, syndicating, managing, and operating the business.

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

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

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

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

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

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

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

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

39 **"§ 105-163.023. Limitations.**

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

44 (1) Qualified securities exchanged for property. – Except as otherwise provided
45 in subdivision (3) of this subsection, a taxpayer who transfers property to a
46 business in exchange for qualified securities in the business must, for
47 purposes of determining North Carolina taxable income, recognize gain
48 equal to the amount by which the fair market value of the property exceeded
49 the taxpayer's basis in the property on the date the property was exchanged
50 for the qualified securities. This gain must be recognized for the years for
51 which the taxpayer claims an exclusion of gain under this Part with respect

1 to the disposition of qualified securities received in exchange for the
2 property.

3 (2) Contributions to capital. – Except as otherwise provided in subdivision (3) of
4 this subsection, if the adjusted basis of a qualified security is adjusted due to
5 a contribution to capital after the date the qualified security was issued
6 originally, for purposes of determining North Carolina taxable income, the
7 taxpayer must recognize gain equal to the amount by which the fair market
8 value of the contributed property exceeded the taxpayer's basis in the
9 property on the date the property was contributed. This gain must be
10 recognized for the years for which the taxpayer claims an exclusion of gain
11 under this Part with respect to the disposition of the qualified securities.

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

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

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

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

31 **SECTION 4.** This act is effective when it becomes law.