

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2011

H.B. 1118
May 23, 2012
HOUSE PRINCIPAL CLERK

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HOUSE DRH80336-MC-267W (05/15)

Short Title: Small Business Start-Up Tax Relief.

(Public)

Sponsors: Representative Wray.

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO PROVIDE TAX RELIEF FOR SMALL START-UP BUSINESSES.
3 The General Assembly of North Carolina enacts:

4 **SECTION 1.** G.S. 105-134.6(b) is amended by adding a new subdivision to read:
5 "(b) Other Deductions. – In calculating North Carolina taxable income, a taxpayer may
6 deduct any of the following items to the extent those items are included in the taxpayer's
7 adjusted gross income.

8 ...
9 (23) The amount of the exclusion of gain for qualified businesses allowed under
10 Part 5 of this Article, plus an amount equal to the amount of the credits
11 recaptured pursuant to G.S. 105-163.021."

12 **SECTION 2.** G.S. 105-163.013 and G.S. 105-163.015 are recodified as
13 G.S. 105-163.010A and G.S. 105-163.010B, respectively.

14 **SECTION 3.** Part 5 of Article 4 of Chapter 105 of the General Statutes reads as
15 rewritten:

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

17 "Subpart 1. General Provisions.

18 "**§ 105-163.010. Definitions.**

19 The following definitions apply in this Part:

20 ...
21 (4) Equity security. – Common stock, preferred stock, or an interest in a
22 ~~partnership~~ partnership or limited liability company, or subordinated debt
23 that is convertible into, or entitles the holder to receive upon its exercise,
24 common stock, preferred stock, or an interest in a ~~partnership~~ partnership or
25 limited liability company.

26 ...
27 (8) Qualified business venture. – A business that (i) engages primarily in
28 manufacturing, processing, warehousing, wholesaling, research and
29 development, or a service-related industry, and (ii) is registered with the
30 Secretary of State under G.S. ~~105-163.013~~ 105-163.010A.

31 (9) Qualified grantee business. – A business that (i) is registered with the
32 Secretary of State under G.S. ~~105-163.013~~ 105-163.010A, and (ii) has
33 received during the current year or any of the preceding three years a grant,
34 an investment, or other funding from a federal agency under the Small
35 Business Innovation Research Program administered by the United States



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1 Small Business Administration or from a granting entity as defined in this
2 section.

3 (9a) Qualified licensee business. – A business that meets all of the following
4 conditions:

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

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

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

21 ...
22 (13) Service-related industry. – A business is engaged in a service-related
23 industry, whether or not it also sells a product, if it provides services to
24 customers or clients and does not as a substantial part of its business engage
25 in a business described in ~~105-163.013(b)(4).~~ G.S. 105-163.010A(b)(4). A
26 business is engaged as a substantial part of its business in an activity
27 described in ~~G.S. 105-163.013(b)(4)~~ G.S. 105-163.010A(b)(4) if (i) its gross
28 revenues derived from all activities described in that subdivision exceed
29 twenty-five percent (25%) of its gross revenues in any fiscal year or (ii) it is
30 established as one of its primary purposes to engage in any activities
31 described in that subdivision, whether or not its purposes were stated in its
32 articles of incorporation or similar organization documents.

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

40 **"§ 105-163.010A. Registration.**

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

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

49 ...
50 (4) It does not engage as a substantial part of its business in any of the
51 following:

1 ...
2 d. ~~The purchase, sale, or development, or purchasing,~~Purchasing,
3 developing, selling, or holding for investment of commercial paper,
4 notes, other indebtedness, financial instruments, securities, or real
5 property, or otherwise ~~make~~making investments.

6 ...
7 (5) It was not formed for the primary purpose of acquiring all or part of the
8 ~~stock~~stock, other ownership interest, or assets of one or more existing
9 businesses.

10 (6) It is not a real estate-related business.

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

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

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

36 If the gross revenues of a qualified business venture exceed five million dollars
37 (\$5,000,000) in a fiscal year, the business must notify the Secretary of State in writing of this
38 fact by filing a financial statement showing the revenues of the business for that year.

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

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

50 To remain qualified as a qualified licensee business, the business must renew its registration
51 annually as prescribed by rule by filing a financial statement for the most recent fiscal year

1 showing gross revenues, as determined in accordance with generally accepted accounting
2 principles, of one million dollars (\$1,000,000) or less on a consolidated basis and an
3 application for renewal in which the business certifies the facts required in the original
4 application.

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

17 If the gross revenues of a qualified licensee business ~~venture~~ exceed one million dollars
18 (\$1,000,000) in a fiscal year, the business must notify the Secretary of State in writing of this
19 fact by filing a financial statement showing the revenues of the business for that year.

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

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

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

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

49 The fee for filing an application for registration under this section is one hundred dollars
50 (\$100.00). The fee for filing an application for renewal of registration under this section is fifty

1 dollars (\$50.00). The fee for filing an application for reinstatement of registration under this
2 section is fifty dollars (\$50.00).

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

9 ...
10 **"§ 105-163.010B. Sunset.**

11 This Part is repealed effective for investments made on or after January 1, ~~2013~~2016.

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

13 **"§ 105-163.011. Tax credits allowed.**

14 ...
15 **"§ 105-163.012. Limit; carry-over; ceiling; reduction in basis.**

16 ...
17 (b) The total amount of all tax credits allowed to taxpayers under G.S. 105-163.011 for
18 investments made in a calendar year may not exceed ~~seven ten million five hundred thousand~~
19 ~~dollars (\$7,500,000)~~(\$10,000,000). The Secretary of Revenue shall calculate the total amount
20 of tax credits claimed from the applications filed pursuant to G.S. 105-163.011(c). If the total
21 amount of tax credits claimed for investments made in a calendar year exceeds this maximum
22 amount, the Secretary shall allow a portion of the credits claimed by allocating the maximum
23 amount in tax credits in proportion to the size of the credit claimed by each taxpayer.

24 ...
25 **"§ 105-163.014. Forfeiture of credit.**

26 ...
27 "Subpart 3. Exclusion of Gain on Qualified Business Investment.

28 **"§ 105-163.020. Exclusion of gain allowed.**

29 (a) Individuals. – An individual may elect to exclude from the individual's income
30 taxable under this Article any gain or other taxable income recognized for federal income tax
31 purposes from the sale or exchange of qualified securities.

32 (b) Gain Recognized on Sales by Pass-Through Entities. – This subsection does not
33 apply to a pass-through entity that has committed capital under management in excess of five
34 million dollars (\$5,000,000) or to a pass-through entity that is a qualified business or a North
35 Carolina Enterprise Corporation. Each individual that is an owner of a pass-through entity may
36 elect to exclude from the individual's income taxable under this Article an amount equal to the
37 individual's allocated share of the exclusion for which the pass-through entity would be eligible
38 under subsection (a) of this section if the pass-through entity were an individual .

39 (c) Gain Recognized on Sale of Pass-Through Entities. – This subsection does not apply
40 to a pass-through entity that has committed capital under management in excess of five million
41 dollars (\$5,000,000) or to a pass-through entity that is a qualified business or a North Carolina
42 Enterprise Corporation. An individual may exclude from the individual's income taxable under
43 this Article a portion of the gain or other taxable income recognized as a result of the
44 individual's sale or exchange of an ownership interest in the pass-through entity that invested in
45 qualified securities. The portion of the gain or other taxable income that may be excluded from
46 income taxable under this Article is the gain or other taxable income recognized as a result of
47 the sale or exchange of an ownership interest in the pass-through entity multiplied by a fraction,
48 the numerator of which is the total amount invested by the pass-through entity in qualified
49 securities and the denominator of which is the total amount invested by the pass-through entity.
50 For purposes of this subsection, the amounts invested by a pass-through entity shall be the
51 amounts invested at the time of the pass-through entity's sale or exchange.

1 (d) Election Irrevocable. – A taxpayer's election as to whether to exclude gain from
2 taxable income becomes irrevocable upon filing the taxpayer's income tax return for the taxable
3 year.

4 **"§ 105-163.021. Recapture of credit.**

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

10 **"§ 105-163.022. Qualified securities.**

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

- 14 (1) It is originally issued by the business on or after January 1, 2012.
- 15 (2) As of the date of issuance, the issuing business is a qualified business.
- 16 (3) The security or instrument is acquired by the taxpayer at its original issue in
17 exchange for any tangible or intangible property or benefit to the business,
18 including cash, promissory notes, services performed, contracts for services
19 to be performed, or other equity securities of the business.
- 20 (4) It is held by the taxpayer for a continuous period of more than one year.
- 21 (5) No broker's fee or commission or other similar remuneration is paid or given
22 directly or indirectly for soliciting the purchase.
- 23 (6) If the security or instrument was purchased by a pass-through entity, the
24 entity met the requirements of G.S. 105-163.011(b) at the time of purchase.

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

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

- 39 (1) Purchases, directly or indirectly, any of its outstanding equity securities or
40 subordinated debt, other than qualified securities, from the taxpayer or a
41 related person.
- 42 (2) Declares a dividend or makes a distribution with respect to any of its
43 outstanding equity securities or subordinated debt, other than qualified
44 securities, to the taxpayer or a related person. This subdivision does not
45 apply, however, to a distribution in connection with one of the following:
 - 46 a. The reimbursement to the taxpayer of the reasonable costs of
47 forming, syndicating, managing, and operating the business.
 - 48 b. An increase in the taxpayer's taxes, penalties, or interest to the extent
49 the increase is caused by the allocation to the taxpayer of income of
50 the business. The repayment of principal on subordinated debt is a
51 purchase of the debt except to the extent the repayment is repayment

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

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

10 (1) Any deemed liquidation of a business pursuant to section 708(b)(1)(A) of
11 the Code by reason of the business becoming a disregarded entity for federal
12 tax purposes, to the extent there is no actual distribution of money or other
13 property to the taxpayer or a related person.

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

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

24 (f) Transfers. – In the case of a transfer by gift, by death, or from a pass-through entity
25 to one of its owners, the transferee is considered, for the purpose of this section, to have
26 acquired the qualified security in the same manner as the transferor and to have held it during
27 any continuous period immediately preceding the transfer during which it was held or treated as
28 held by the transferor. In the case of a transaction described in section 351 or 721 of the Code
29 or a reorganization described in section 368 of the Code, if qualified securities are exchanged
30 for other securities, the other securities are considered, for the purpose of this section, qualified
31 securities acquired on the date the exchanged qualified securities were acquired. In the case of a
32 transaction described in section 351 or 721 of the Code, the newly acquired securities are
33 considered qualified securities, however, only if, immediately after the transaction, the business
34 issuing the securities owns, directly or indirectly, securities representing control, within the
35 meaning of section 368(c) of the Code, of the business whose securities were exchanged.

36 **"§ 105-163.023. Limitations.**

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

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

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

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

17 (b) Transactions That Substantially Reduce the Risk of Loss. – If a taxpayer has entered
18 into any transaction that substantially reduces the risk of loss from holding the qualified
19 securities, there is no exclusion of gain under this Part from the sale or exchange of the
20 qualified securities unless the taxpayer entered into the transaction on or after January 1, 2012,
21 and elects to recognize gain as if the qualified securities were sold at fair market value on the
22 date the taxpayer first entered into that transaction. The following are examples of a transaction
23 that substantially reduces the risk of loss from holding the qualified securities:

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

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

28 **SECTION 4.** This act is effective for taxable years beginning on or after January 1,
29 2012.