

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1995

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SENATE BILL 702

Short Title: Small Business Gain Exclusion.

(Public)

Sponsors: Senator Perdue.

Referred to: Finance

April 13, 1995

A BILL TO BE ENTITLED

AN ACT TO EXCLUDE FROM INCOME TAX CERTAIN GAINS FROM
INVESTMENTS IN QUALIFIED NORTH CAROLINA BUSINESSES.

The General Assembly of North Carolina enacts:

Section 1. This act shall be known as the Small Business Exclusion of Gain Act.

Sec. 2. G.S. 105-130.5(b) is amended by adding a new subdivision to read:

"(17) The amount of the exclusion of gain for qualified North Carolina businesses allowed under Division V of this Article, to the extent included in federal taxable income."

Sec. 3. G.S. 105-134.6(b) is amended by adding a new subdivision to read:

"(11) The amount of the exclusion of gain for qualified North Carolina businesses allowed under Division V of this Article."

Sec. 4. The title of Division V of Article 4 of Chapter 105 of the General Statutes reads as rewritten:

"DIVISION V. TAX CREDITS INCENTIVES FOR QUALIFIED BUSINESS INVESTMENTS."

Sec. 5. G.S. 105-163.013 is recodified as G.S. 105-163.010A.

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

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

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

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

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

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

31 (d) Conversion of Other Securities. – Any equity security or subordinated debt
32 instrument issued by a business and acquired by the taxpayer solely through the
33 conversion of another equity security or subordinated debt instrument that was issued by
34 the business and was a qualified security in the hands of the taxpayer is considered, for
35 the purpose of this section, a qualified security in the hands of the taxpayer and acquired
36 by the taxpayer on the date the taxpayer acquired the converted qualified security.

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

42 In the case of a transaction described in section 351 of the Code or a reorganization
43 described in section 368 of the Code, if qualified securities are exchanged for other

1 securities, the other securities are considered, for the purpose of this section, qualified
2 securities acquired on the date the exchanged qualified securities were acquired. In the
3 case of a transaction described in section 351 of the Code, the newly acquired securities
4 are considered qualified securities, however, only if, immediately after the transaction,
5 the corporation issuing the securities owns, directly or indirectly, securities representing
6 control, within the meaning of section 368(c) of the Code, of the corporation whose
7 securities were exchanged.

8 **"§ 105-163.022. Limitations.**

9 (a) Contributions and Exchanges of Property. – In the case of a transaction
10 described in section 351 or 721 of the Code or a reorganization described in section 368
11 of the Code, if a taxpayer contributes property to or exchanges property with a qualified
12 North Carolina business, the following rules apply:

13 (1) Qualified securities exchanged for property. – Except as otherwise
14 provided in subdivision (3) of this subsection, a taxpayer who
15 transfers property to a business in exchange for qualified securities
16 in the business shall, for purposes of determining North Carolina
17 taxable income, recognize gain equal to the amount by which the fair
18 market value of the property exceeded the taxpayer's basis in the
19 property on the date the property was exchanged for the qualified
20 securities. This gain shall be recognized for the years for which the
21 taxpayer claims an exclusion of gain under this Division with respect
22 to the disposition of qualified securities received in exchange for the
23 property.

24 (2) Contributions to capital. – Except as otherwise provided in
25 subdivision (3) of this subsection, if the adjusted basis of a qualified
26 security is adjusted due to a contribution to capital after the date the
27 qualified security was issued originally, for purposes of determining
28 North Carolina taxable income, the taxpayer shall recognize gain
29 equal to the amount by which the fair market value of the
30 contributed property exceeded the taxpayer's basis in the property on
31 the date the property was contributed. This gain shall be recognized
32 for the years for which the taxpayer claims an exclusion of gain
33 under this Division with respect to the disposition of the qualified
34 securities.

35 (3) Disposition of contributed property. – If a qualified North Carolina
36 business disposes of property contributed to it, the disposition occurs
37 before the taxpayer who contributed the property claims an
38 exclusion of gain pursuant to this Division with respect to qualified
39 securities affected by the contribution, and the taxpayer recognizes
40 gain from the disposition, then for purposes of subdivisions (1) and
41 (2) of this subsection, the taxpayer's basis in the contributed property
42 is increased by any gain the taxpayer recognized from the
43 disposition.

1 (b) Short Positions. – For the purposes of this subsection, a taxpayer has an
2 offsetting short position with respect to qualified securities if one of the following
3 conditions is satisfied:

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

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

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

12 If a taxpayer has an offsetting short position with respect to any qualified securities, there
13 shall be no exclusion of gain under this Division from the sale or exchange of the
14 qualified securities unless the taxpayer established the short position on or after January
15 1, 2000, and elects to recognize gain as if the qualified securities were sold at fair market
16 value on the date the taxpayer first established the short position.

17 (c) Guidelines. – The Secretary shall adopt guidelines identifying transactions that
18 substantially reduce the risk of loss from holding qualifying securities for the purpose of
19 subsection (b) of this section. In addition, the Secretary shall adopt guidelines identifying
20 activities and situations designed to avoid the purpose of this Division through split-ups,
21 shell corporations, partnerships, or otherwise. There shall be no exclusion of gain
22 otherwise allowable under this Division to the extent a taxpayer has engaged in an
23 activity or created a situation identified by the Secretary in guidelines as one that is
24 designed to avoid the purpose of this Division."

25 Sec. 10. G.S. 105-163.010 is amended by adding a new subdivision to read:

26 "(8a) Qualified North Carolina business. – A North Carolina Enterprise
27 Corporation, a qualified grantee business registered under this
28 Division, or a qualified business venture registered under this
29 Division."

30 Sec. 11. G.S. 105-163.010 is amended by renumbering subdivision (9a) as
31 (8c) and adding a new subdivision to read:

32 "(9a) Related person. – A related person as determined under section
33 267(b) or 707(b) of the Code."

34 Sec. 12. G.S. 105-163.010(2) reads as rewritten:

35 "(2) Business. – A corporation, a partnership, a limited liability company,
36 an association, or a sole proprietorship operated for profit."

37 Sec. 13. G.S. 105-163.010(4) reads as rewritten:

38 "(4) Equity security. – Common stock, preferred stock, or an interest in a
39 ~~partnership~~, partnership or limited liability company, or subordinated
40 debt that is convertible into, or entitles the holder to receive upon its
41 exercise, common stock, preferred stock, or an interest in a
42 partnership."

43 Sec. 14. G.S. 105-163.010(9b) reads as rewritten:

1 "(9b) Selling or leasing at retail. —~~A business is selling or leasing at retail~~
2 ~~if the business either (i) sells or leases any product or~~ Any of the
3 ~~following:~~

4 a. Selling or leasing any service of any nature from a store or other
5 location open to the public ~~generally or (ii) sells or leases products~~
6 ~~or generally.~~

7 b. Selling or leasing services of any nature by means other than to
8 or through one or more other businesses.

9 c. Reselling or leasing at retail products that are purchased or leased
10 at wholesale and then resold or leased substantially unmodified."

11 Sec. 15. G.S. 105-163.010(11) reads as rewritten:

12 "(11) Subordinated debt. — ~~Indebtedness that (i) by its terms matures five or~~
13 ~~more years after its issuance, (ii) is not secured, and (iii) is not secured~~
14 and is subordinated to all other indebtedness of the issuer issued or
15 to be issued to a financial institution other than a financial institution
16 described in subdivisions (5)(ii) through (5)(v) of this section. ~~Any~~
17 For the purpose of Part 2 of this Division only, any portion of
18 indebtedness that matures earlier than five years after its issuance is
19 not subordinated debt."

20 Sec. 16. G.S. 105-163.010A(b)(1), as recodified by this act, reads as rewritten:

21 "(1) Its headquarters and principal business operations are in North
22 Carolina or it has, as a condition to approval of the registration,
23 agreed to establish its headquarters and principal business operations
24 in North Carolina within three months after the later of the date its
25 application is accepted or the date the first investment eligible for a
26 credit or an exclusion of gain under this Division is made."

27 Sec. 17. G.S. 105-163.010A(b)(2), as recodified by this act, reads as rewritten:

28 "(2) It has, as a condition to approval of the registration, agreed to retain
29 its headquarters and principal business operations in North Carolina
30 for at least three years after the later of the date its application is
31 accepted or the date the last investment eligible for credit under this
32 Division is made."

33 Sec. 18. G.S. 105-163.010A(b)(5), as recodified by this act, reads as rewritten:

34 "(5) It was not formed for the primary purpose of acquiring all or part of
35 the ~~stock~~ stock, other ownership interest, or assets of one or more
36 existing businesses."

37 Sec. 19. G.S. 105-163.010A(c)(1), as recodified by this act, reads as rewritten:

38 "(1) Its headquarters and principal business operations are in North
39 Carolina or it has, as a condition to approval of the registration,
40 agreed to establish its headquarters and principal business operations
41 in North Carolina within three months after the later of the date its
42 application is accepted or the date the first investment eligible for a
43 credit or an exclusion of gain under this Division is made."

1 Sec. 20. G.S. 105-163.010A(c)(2), as recodified by this act, reads as rewritten:

2 "(2) It has, as a condition to approval of the registration, agreed to retain
3 its headquarters and principal business operations in North Carolina
4 for at least three years after the later of the date its application is
5 accepted or the date the last investment eligible for a credit under
6 this Division is made."

7 Sec. 21. G.S. 105-163.010A(d), as recodified by this act, reads as rewritten:

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

23 The fee for filing an application for registration under this section is one hundred
24 dollars (\$100.00). The fee for filing an application for renewal of registration under this
25 section is fifty dollars (\$50.00). The fee for filing an application for reinstatement of
26 registration under this section is fifty dollars (\$50.00).

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

34 Sec. 22. This act is effective upon ratification. Notwithstanding the provisions
35 of G.S. 105-163.010A as recodified by this act, if a qualified North Carolina business
36 files its application for registration within 60 days after the effective date of this act and
37 the application is accepted, the effective date of the registration is the later of January 1,
38 1995, or the date the business first issues equity securities or subordinated debt. Part 3 of
39 Division V of Article 4 of Chapter 105 of the General Statutes, as amended by this act, is
40 repealed effective for equity securities and subordinated debt instruments acquired on or
41 after January 1, 2003.