

DRAFT

SUMMARY

Allows deferral of gain, for purposes of state personal income taxes, on sale or other disposition of capital assets if proceeds are reinvested in qualified business interest, qualified investment fund or qualified business asset. Reduces basis of qualified business interest, qualified investment fund or qualified business asset by amount of deferred gain. Requires reinvestment of full amount of proceeds to fully defer tax. Allows Department of Revenue to adopt rules to define what constitutes interim holding or incidental holding.

Defines terms. Requires report to Legislative Assembly. Makes technical changes.

Repeals provisions of earlier deferral program.

Applies to investments made on or after January 1, 2012, and to tax years beginning on or after January 1, 2012.

Takes effect on 91st day following adjournment sine die.

A BILL FOR AN ACT

1
2 Relating to tax treatment of capital gains; creating new provisions; repealing
3 ORS 316.873, 316.874, 316.876, 316.877, 316.878, 316.879, 316.881, 316.882,
4 316.883 and 316.884; and prescribing an effective date.

5 **Be It Enacted by the People of the State of Oregon:**

6 **SECTION 1. Sections 2 to 11 of this 2011 Act are added to and made**
7 **a part of ORS chapter 316.**

8 **SECTION 2. As used in sections 2 to 11 of this 2011 Act:**

9 **(1) “Capital asset” means an asset defined as a capital asset under**
10 **section 1221 of the Internal Revenue Code, except that it includes**
11 **property, used in the taxpayer’s trade or business, of a character that**
12 **is subject to the allowance for depreciation provided in section 167 of**
13 **the Internal Revenue Code, or real property used in the taxpayer’s**

1 **trade or business.**

2 **(2) “Commercial domicile” means commercial domicile as defined**
3 **under ORS 314.610.**

4 **(3) “Expansion share” means a unit of ownership of a business that**
5 **meets all of the following criteria:**

6 **(a) The unit has unlimited voting rights and the right to receive a**
7 **share of the net assets of the business upon dissolution, or may at the**
8 **option of the holder of the share be converted into shares with these**
9 **characteristics.**

10 **(b) The unit is issued directly to the taxpayer, or to a partnership,**
11 **limited liability company or S corporation of which the taxpayer is,**
12 **at the time the unit is issued, a partner, member or shareholder.**

13 **(c) The business has less than \$5 million in revenues during the 12**
14 **full months immediately preceding the date of the first equity invest-**
15 **ment in the business by the taxpayer.**

16 **(d) At the time the unit is issued, the business has a net equity,**
17 **adjusted by adding back all dividends or distributions made by the**
18 **business, that is equal to or less than the sum of all previous equity**
19 **investments.**

20 **(e) At the time the unit is issued, no unit of ownership of the**
21 **business is publicly traded.**

22 **(f) The unit is issued in exchange for money or property to be used**
23 **in the operations of the business. A unit, the proceeds received by the**
24 **business of which are used by the business to reacquire an ownership**
25 **interest or other security of the business, does not constitute an ex-**
26 **pansion share.**

27 **(4) “Gain” or “deferred gain” means gain as determined for federal**
28 **income tax purposes with the modifications contained in this chapter.**

29 **(5) “Qualified business interest” means an ownership interest in a**
30 **business conducting a qualified business activity.**

31 **(6) “Qualified business activity” means a business that is owned by**

1 an individual, partnership, limited liability company, S corporation or
2 C corporation, the activity of which meets all of the following criteria:

3 (a) The activity is an activity, other than finance, insurance or real
4 estate, listed in the Standard Industrial Classification Manual, 1987
5 (SIC), as published by the Office of Management and Budget, Execu-
6 tive Office of the President.

7 (b) The business generates income from investment property only
8 as an incidental effect of the management of working capital. For
9 purposes of sections 2 to 11 of this 2011 Act, ownership interests in
10 entities controlled by the business or directly involved in the support
11 of the qualified business activity of the business do not constitute in-
12 vestment property.

13 (c) The commercial domicile of the business is in this state.

14 (d)(A) The employment base of the business in this state is at least
15 as large as the employment base of the business outside this state.

16 (B) For purposes of this paragraph, the employment base of a
17 business shall be the sum of the number of full-time equivalent em-
18 ployees and the number of full-time equivalent independent contrac-
19 tors located in this state or outside this state, as the case may be.

20 (7) "Qualified business asset" means a capital asset held for use in
21 this state in a qualified business activity.

22 (8) "Related party" means an individual who is a member of the
23 taxpayer's family, as that term is defined in section 267 (c)(4) of the
24 Internal Revenue Code.

25 (9) "Qualified investment fund" means a partnership, limited li-
26 ability company or S corporation formed solely for the purpose of ac-
27 quiring qualified business interests or qualified business assets and
28 that:

29 (a) Invests in qualified business interests or qualified business as-
30 sets; or

31 (b) Acquires investment property only on an interim basis or an

1 incidental basis until a suitable qualified business interest or qualified
2 business asset may be located by the fund.

3 (10) "Investment property" means property that has the capacity
4 to produce gross income from:

5 (a) Interest, annuities or royalties not derived in the ordinary
6 course of a trade or business; or

7 (b) Dividends, except that investment property does not include
8 expansion shares.

9 SECTION 3. (1) In addition to any other modifications to federal
10 taxable income made for purposes of this chapter, and upon the filing
11 by the taxpayer of a declaration described under section 5 (1) of this
12 2011 Act, a taxpayer who has income for federal income tax purposes,
13 from gain on the sale or other disposition of a capital asset may defer
14 recognition of all or part of the gain in determining the taxes imposed
15 under this chapter by reinvesting the proceeds of the sale or other
16 disposition in a qualified business interest, qualified investment fund
17 or qualified business asset within six months of the date on which the
18 gain would otherwise have been recognized.

19 (2) For purposes of sections 2 to 11 of this 2011 Act, gain shall be
20 considered to be reinvested in a qualified business interest, qualified
21 investment fund or qualified business asset in the same proportion
22 that the proceeds from the sale or other disposition of the capital asset
23 (net of federal income taxes paid or owing as a result of the sale or
24 other disposition) are reinvested.

25 (3) Upon the sale or other disposition of a qualified business inter-
26 est, interest in a qualified investment fund or a qualified business as-
27 set with respect to which gain was previously deferred under this
28 section as the result of a prior sale or disposition, the previously de-
29 ferred gain may continue to be deferred:

30 (a) Only to the extent that an amount equal to the total of all gain
31 deferred under this section is reinvested in one or more qualified

1 **business interests or qualified business assets; and**

2 **(b) Only if a new declaration described under section 5 (1) of this**
3 **2011 Act is filed with the Department of Revenue.**

4 **(4) Gain resulting from the sale or other disposition of a qualified**
5 **business interest, interest in a qualified investment fund or a qualified**
6 **business asset that the taxpayer may not continue to defer under**
7 **subsection (1) of this section shall be added to federal taxable income**
8 **in the manner provided under section 7 (3) of this 2011 Act.**

9 **(5) The Department of Revenue may by rule further refine the**
10 **method by which a taxpayer determines whether a transaction con-**
11 **stitutes the sale or disposition of a qualified business interest, interest**
12 **in a qualified investment fund or a qualified business asset with re-**
13 **spect to which gain has been deferred.**

14 **SECTION 4. The following types of gain or income may not be de-**
15 **ferred under sections 2 to 11 of this 2011 Act:**

16 **(1) Gain from the sale or other disposition of property received in**
17 **lieu of salary, wages or other compensation for services performed by**
18 **the taxpayer, to the extent of the fair market value of the property**
19 **at the time of receipt by the taxpayer.**

20 **(2) Gain or income from the sale of inventory, except gain derived**
21 **from the bulk sale of inventory not in the ordinary course of a trade**
22 **or business.**

23 **(3) Gain from the sale of property that is not held for the pro-**
24 **duction of income.**

25 **(4) Gain from investment property.**

26 **(5) Gain that is treated or characterized as ordinary income under**
27 **any provision of the Internal Revenue Code.**

28 **SECTION 5. (1) A declaration shall accompany the income tax re-**
29 **turn of a taxpayer seeking to defer gain under sections 2 to 11 of this**
30 **2011 Act. The declaration shall state the source and the amount of the**
31 **gain to be deferred and shall declare the intent of the taxpayer to re-**

1 invest the gain in a qualified business interest, qualified investment
2 fund or a qualified business asset within six months of the date of sale
3 or other disposition from which the gain is derived.

4 (2) A taxpayer who has filed a declaration of intent to reinvest
5 shall, with the income tax return for the tax year of reinvestment, file
6 a statement that the reinvestment has occurred. The statement shall
7 be on such form as the Department of Revenue may prescribe and
8 shall:

9 (a) Identify the qualified business interest, interest in a qualified
10 investment fund or qualified business asset acquired;

11 (b) State the basis for qualification as a qualified business interest,
12 qualified investment fund or qualified business asset; and

13 (c) Give the purchase price or other consideration given for the
14 qualified business interest, interest in the qualified investment fund
15 or qualified business asset acquired.

16 (3) The statement described in subsection (2) of this section shall
17 reference the specific declaration of intent to reinvest that is being
18 fulfilled.

19 SECTION 6. The basis of the taxpayer in a qualified business in-
20 terest, qualified investment fund or qualified business asset shall be
21 reduced by the amount of gain deferred under sections 2 to 11 of this
22 2011 Act.

23 SECTION 7. (1) If a taxpayer is granted a deferral under sections 2
24 to 11 of this 2011 Act, the amount of the deferred gain that is rein-
25 vested in a qualified business interest, qualified investment fund or
26 qualified business asset shall be an adjustment to federal taxable in-
27 come notwithstanding section 3 of this 2011 Act, when any of the fol-
28 lowing occur:

29 (a) The asset ceases to be a qualified business asset.

30 (b) The investment fund ceases to be a qualified investment fund.

31 (c) The business ceases day-to-day operations or ceases to be a

1 **qualified business.**

2 **(d) The current asset value of the qualified business is reduced 50**
3 **percent or more as a result of the withdrawal of:**

4 **(A) Capital assets from the business; or**

5 **(B) Proceeds from the sale or other disposition of capital assets of**
6 **the business.**

7 **(2) For purposes of subsection (1)(b) of this section, a qualified in-**
8 **vestment fund may not be disqualified upon the disqualification of one**
9 **or more of the qualified business activities in which the fund holds**
10 **interests, if the fund divests itself of the fund's interests in the dis-**
11 **qualified business activity within 12 months of the date of disquali-**
12 **fication. If the qualified investment fund does not divest itself of the**
13 **fund's interests in a disqualified business activity within 12 months**
14 **of the disqualification, only that portion of the gain previously de-**
15 **ferred under sections 2 to 11 of this 2011 Act that is attributable to the**
16 **interest in the disqualified business activity shall be an adjustment to**
17 **the federal taxable income of the owners of the fund.**

18 **(3)(a) Except as provided in paragraph (b) of this subsection, upon**
19 **the occurrence of an event described in subsection (1) of this section**
20 **requiring recognition of deferred gain, the deferred gain shall be added**
21 **to federal taxable income for the tax year in which the event occurs.**
22 **Except for adjustments required for purposes of this chapter other**
23 **than in sections 2 to 11 of this 2011 Act, no other adjustment to federal**
24 **taxable income shall be made as a result of an event requiring recog-**
25 **inition of deferred gain described in subsection (1) of this section.**

26 **(b) A taxpayer who does not own a controlling interest in a business**
27 **with respect to which an event occurs requiring recognition of gain**
28 **as described in subsection (1)(a), (b) and (c) of this section may con-**
29 **tinue to defer gain by timely filing a declaration of intent to reinvest**
30 **as described in section 5 of this 2011 Act.**

31 **(c) If a qualified investment fund fails to divest itself of the fund's**

1 interests in a disqualified business activity within the 12-month period
2 described in subsection (2) of this section, the deferred gain that is
3 required to be recognized by subsection (2) of this section shall be
4 added to federal taxable income for the tax year in which expires the
5 12-month period for divestment.

6 **SECTION 8.** (1) If a taxpayer sells or otherwise disposes of a quali-
7 fied business interest or qualified business asset, the statutory period
8 prescribed in ORS 314.410 for assessing a deficiency attributable to any
9 part of the gain deferred under sections 2 to 11 of this 2011 Act may
10 not expire prior to the expiration of three years after the latest of the
11 following dates:

12 (a) The date of receipt by the Department of Revenue of the state-
13 ment described in section 5 (2) of this 2011 Act.

14 (b) The date of receipt by the department of a statement from the
15 taxpayer declaring an intent not to reinvest.

16 (c) The date that is six months after the date of sale or disposition
17 resulting in possible deferred gain.

18 (2) Any gain deferred under sections 2 to 11 of this 2011 Act that is
19 later required to be added to federal taxable income under sections 2
20 to 11 of this 2011 Act shall be added to federal taxable income for the
21 tax year in which the event causing the addition occurs. Any defi-
22 ciency attributable to any portion of deferred gain may be assessed
23 before the expiration of the latest date described under subsection (1)
24 of this section.

25 (3) A taxpayer who files a declaration of intent to reinvest but fails
26 to reinvest as required by section 3 of this 2011 Act shall be liable for
27 unpaid taxes on the deferred amount and for interest at the rate es-
28 tablished under ORS 305.220 for deficiencies from the date that the tax
29 on the deferred gain would have been due had the declaration not been
30 filed to the date of payment.

31 **SECTION 9.** (1) If, on account of death or disability of the taxpayer,

1 a related party succeeds to a qualified business interest, interest in a
2 qualified investment fund or qualified business asset upon the acqui-
3 sition of which gain was deferred under sections 2 to 11 of this 2011
4 Act, then at the election of the related party, the death or disability
5 of the taxpayer does not result in the addition to federal taxable in-
6 come of the deferred gain.

7 (2) The related party who succeeds to the qualified business inter-
8 est, interest in a qualified investment fund or qualified business asset
9 may dispose of the interest or asset without addition of the deferred
10 gain to federal taxable income if the requirements of reinvestment and
11 other requirements of sections 2 to 11 of this 2011 Act are met.

12 (3) If a taxpayer dies, and the death does not result in the addition
13 of the deferred gain to federal taxable income because of an election
14 under this section, at the time the deferred gain is added to federal
15 taxable income, the amount of gain shall be determined using the ba-
16 sis that the deceased taxpayer had in the qualified business interest,
17 qualified investment fund or qualified business asset.

18 SECTION 10. The Department of Revenue may adopt rules under
19 sections 2 to 11 of this 2011 Act including rules that define what con-
20 stitutes an interim holding of investment property by a qualified in-
21 vestment fund and an incidental holding of investment property by a
22 qualified business activity or a qualified investment fund.

23 SECTION 11. (1) Sections 2 to 10 of this 2011 Act apply to gain in-
24 curred from the sale or other disposition of a capital asset in tax years
25 beginning on or after January 1, 2012, and to investments in qualified
26 business interests, qualified investment funds or qualified business
27 assets that occur on or before December 31, 2015.

28 (2)(a) The Department of Revenue, in conjunction with the Oregon
29 Business Development Department and the Legislative Revenue Offi-
30 cer, shall prepare a report regarding the economic impact of sections
31 2 to 10 of this 2011 Act and shall present the report to those commit-

1 **tees of the Seventy-seventh Legislative Assembly to which revenue**
2 **matters are assigned. The purpose of the report is to analyze the job**
3 **creation and tax implications of sections 2 to 10 of this 2011 Act.**

4 **(b) The confidentiality requirements applicable to tax returns and**
5 **the information contained therein is not applicable to the Oregon**
6 **Business Development Department and the Legislative Revenue Offi-**
7 **cer for purposes of preparing the report described in paragraph (a) of**
8 **this subsection.**

9 **SECTION 12. ORS 316.873, 316.874, 316.876, 316.877, 316.878, 316.879,**
10 **316.881, 316.882, 316.883 and 316.884 are repealed on the effective date**
11 **of this 2011 Act.**

12 **SECTION 13. This 2011 Act takes effect on the 91st day after the**
13 **date on which the 2011 regular session of the Seventy-sixth Legislative**
14 **Assembly adjourns sine die.**

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