

Senate Bill 824

Sponsored by COMMITTEE ON FINANCE AND REVENUE

SUMMARY

The following summary is not prepared by the sponsors of the measure and is not a part of the body thereof subject to consideration by the Legislative Assembly. It is an editor's brief statement of the essential features of the measure **as introduced**.

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 ORS 316.873, 316.874,
3 316.876, 316.877, 316.878, 316.879, 316.881, 316.882, 316.883 and 316.884; and prescribing an ef-
4 fective 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 a part of ORS**
7 **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 section 1221 of the**
10 **Internal Revenue Code, except that it includes property, used in the taxpayer's trade or**
11 **business, of a character that is subject to the allowance for depreciation provided in section**
12 **167 of the Internal Revenue Code, or real property used in the taxpayer's trade or business.**

13 (2) **"Commercial domicile" means commercial domicile as defined under ORS 314.610.**

14 (3) **"Expansion share" means a unit of ownership of a business that meets all of the fol-**
15 **lowing criteria:**

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

19 (b) **The unit is issued directly to the taxpayer, or to a partnership, limited liability com-**
20 **pany or S corporation of which the taxpayer is, at the time the unit is issued, a partner,**
21 **member or shareholder.**

22 (c) **The business has less than \$5 million in revenues during the 12 full months imme-**
23 **diately preceding the date of the first equity investment in the business by the taxpayer.**

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

NOTE: Matter in **boldfaced** type in an amended section is new; matter [*italic and bracketed*] is existing law to be omitted. New sections are in **boldfaced** type.

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

2 (f) The unit is issued in exchange for money or property to be used in the operations of
3 the business. A unit, the proceeds received by the business of which are used by the business
4 to reacquire an ownership interest or other security of the business, does not constitute an
5 expansion share.

6 (4) "Gain" or "deferred gain" means gain as determined for federal income tax purposes
7 with the modifications contained in this chapter.

8 (5) "Qualified business interest" means an ownership interest in a business conducting
9 a qualified business activity.

10 (6) "Qualified business activity" means a business that is owned by an individual, part-
11 nership, limited liability company, S corporation or C corporation, the activity of which
12 meets all of the following criteria:

13 (a) The activity is an activity, other than finance, insurance or real estate, listed in the
14 Standard Industrial Classification Manual, 1987 (SIC), as published by the Office of Manage-
15 ment and Budget, Executive Office of the President.

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

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

21 (d)(A) The employment base of the business in this state is at least as large as the em-
22 ployment base of the business outside this state.

23 (B) For purposes of this paragraph, the employment base of a business shall be the sum
24 of the number of full-time equivalent employees and the number of full-time equivalent in-
25 dependent contractors located in this state or outside this state, as the case may be.

26 (7) "Qualified business asset" means a capital asset held for use in this state in a quali-
27 fied business activity.

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

30 (9) "Qualified investment fund" means a partnership, limited liability company or S cor-
31 poration formed solely for the purpose of acquiring qualified business interests or qualified
32 business assets and that:

33 (a) Invests in qualified business interests or qualified business assets; or

34 (b) Acquires investment property only on an interim basis or an incidental basis until a
35 suitable qualified business interest or qualified business asset may be located by the fund.

36 (10) "Investment property" means property that has the capacity to produce gross in-
37 come from:

38 (a) Interest, annuities or royalties not derived in the ordinary course of a trade or busi-
39 ness; or

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

41 **SECTION 3.** (1) In addition to any other modifications to federal taxable income made for
42 purposes of this chapter, and upon the filing by the taxpayer of a declaration described under
43 section 5 (1) of this 2011 Act, a taxpayer who has income for federal income tax purposes,
44 from gain on the sale or other disposition of a capital asset may defer recognition of all or
45 part of the gain in determining the taxes imposed under this chapter by reinvesting the

1 proceeds of the sale or other disposition in a qualified business interest, qualified investment
2 fund or qualified business asset within six months of the date on which the gain would oth-
3 erwise have been recognized.

4 (2) For purposes of sections 2 to 11 of this 2011 Act, gain shall be considered to be rein-
5 vested in a qualified business interest, qualified investment fund or qualified business asset
6 in the same proportion that the proceeds from the sale or other disposition of the capital
7 asset (net of federal income taxes paid or owing as a result of the sale or other disposition)
8 are reinvested.

9 (3) Upon the sale or other disposition of a qualified business interest, interest in a qual-
10 ified investment fund or a qualified business asset with respect to which gain was previously
11 deferred under this section as the result of a prior sale or disposition, the previously deferred
12 gain may continue to be deferred:

13 (a) Only to the extent that an amount equal to the total of all gain deferred under this
14 section is reinvested in one or more qualified business interests or qualified business assets;
15 and

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

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

22 (5) The Department of Revenue may by rule further refine the method by which a tax-
23 payer determines whether a transaction constitutes the sale or disposition of a qualified
24 business interest, interest in a qualified investment fund or a qualified business asset with
25 respect to which gain has been deferred.

26 **SECTION 4.** The following types of gain or income may not be deferred under sections 2
27 to 11 of this 2011 Act:

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

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

33 (3) Gain from the sale of property that is not held for the production of income.

34 (4) Gain from investment property.

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

37 **SECTION 5.** (1) A declaration shall accompany the income tax return of a taxpayer
38 seeking to defer gain under sections 2 to 11 of this 2011 Act. The declaration shall state the
39 source and the amount of the gain to be deferred and shall declare the intent of the taxpayer
40 to reinvest the gain in a qualified business interest, qualified investment fund or a qualified
41 business asset within six months of the date of sale or other disposition from which the gain
42 is derived.

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

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

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

5 (c) Give the purchase price or other consideration given for the qualified business inter-
6 est, interest in the qualified investment fund or qualified business asset acquired.

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

9 **SECTION 6.** The basis of the taxpayer in a qualified business interest, qualified invest-
10 ment fund or qualified business asset shall be reduced by the amount of gain deferred under
11 sections 2 to 11 of this 2011 Act.

12 **SECTION 7.** (1) If a taxpayer is granted a deferral under sections 2 to 11 of this 2011 Act,
13 the amount of the deferred gain that is reinvested in a qualified business interest, qualified
14 investment fund or qualified business asset shall be an adjustment to federal taxable income
15 notwithstanding section 3 of this 2011 Act, when any of the following occur:

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

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

18 (c) The business ceases day-to-day operations or ceases to be a qualified business.

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

21 (A) Capital assets from the business; or

22 (B) Proceeds from the sale or other disposition of capital assets of the business.

23 (2) For purposes of subsection (1)(b) of this section, a qualified investment fund may not
24 be disqualified upon the disqualification of one or more of the qualified business activities in
25 which the fund holds interests, if the fund divests itself of the fund's interests in the dis-
26 qualified business activity within 12 months of the date of disqualification. If the qualified
27 investment fund does not divest itself of the fund's interests in a disqualified business ac-
28 tivity within 12 months of the disqualification, only that portion of the gain previously de-
29 ferred under sections 2 to 11 of this 2011 Act that is attributable to the interest in the
30 disqualified business activity shall be an adjustment to the federal taxable income of the
31 owners of the fund.

32 (3)(a) Except as provided in paragraph (b) of this subsection, upon the occurrence of an
33 event described in subsection (1) of this section requiring recognition of deferred gain, the
34 deferred gain shall be added to federal taxable income for the tax year in which the event
35 occurs. Except for adjustments required for purposes of this chapter other than in sections
36 2 to 11 of this 2011 Act, no other adjustment to federal taxable income shall be made as a
37 result of an event requiring recognition of deferred gain described in subsection (1) of this
38 section.

39 (b) A taxpayer who does not own a controlling interest in a business with respect to
40 which an event occurs requiring recognition of gain as described in subsection (1)(a), (b) and
41 (c) of this section may continue to defer gain by timely filing a declaration of intent to re-
42 invest as described in section 5 of this 2011 Act.

43 (c) If a qualified investment fund fails to divest itself of the fund's interests in a dis-
44 qualified business activity within the 12-month period described in subsection (2) of this
45 section, the deferred gain that is required to be recognized by subsection (2) of this section

1 shall be added to federal taxable income for the tax year in which expires the 12-month pe-
2 riod for divestment.

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

8 (a) The date of receipt by the Department of Revenue of the statement described in
9 section 5 (2) of this 2011 Act.

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

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

14 (2) Any gain deferred under sections 2 to 11 of this 2011 Act that is later required to be
15 added to federal taxable income under sections 2 to 11 of this 2011 Act shall be added to
16 federal taxable income for the tax year in which the event causing the addition occurs. Any
17 deficiency attributable to any portion of deferred gain may be assessed before the expiration
18 of the latest date described under subsection (1) of this section.

19 (3) A taxpayer who files a declaration of intent to reinvest but fails to reinvest as re-
20 quired by section 3 of this 2011 Act shall be liable for unpaid taxes on the deferred amount
21 and for interest at the rate established under ORS 305.220 for deficiencies from the date that
22 the tax on the deferred gain would have been due had the declaration not been filed to the
23 date of payment.

24 **SECTION 9.** (1) If, on account of death or disability of the taxpayer, a related party
25 succeeds to a qualified business interest, interest in a qualified investment fund or qualified
26 business asset upon the acquisition of which gain was deferred under sections 2 to 11 of this
27 2011 Act, then at the election of the related party, the death or disability of the taxpayer does
28 not result in the addition to federal taxable income of the deferred gain.

29 (2) The related party who succeeds to the qualified business interest, interest in a quali-
30 fied investment fund or qualified business asset may dispose of the interest or asset without
31 addition of the deferred gain to federal taxable income if the requirements of reinvestment
32 and other requirements of sections 2 to 11 of this 2011 Act are met.

33 (3) If a taxpayer dies, and the death does not result in the addition of the deferred gain
34 to federal taxable income because of an election under this section, at the time the deferred
35 gain is added to federal taxable income, the amount of gain shall be determined using the
36 basis that the deceased taxpayer had in the qualified business interest, qualified investment
37 fund or qualified business asset.

38 **SECTION 10.** The Department of Revenue may adopt rules under sections 2 to 11 of this
39 2011 Act including rules that define what constitutes an interim holding of investment
40 property by a qualified investment fund and an incidental holding of investment property by
41 a qualified business activity or a qualified investment fund.

42 **SECTION 11.** (1) Sections 2 to 10 of this 2011 Act apply to gain incurred from the sale
43 or other disposition of a capital asset in tax years beginning on or after January 1, 2012, and
44 to investments in qualified business interests, qualified investment funds or qualified busi-
45 ness assets that occur on or before December 31, 2015.

1 **(2)(a) The Department of Revenue, in conjunction with the Oregon Business Development**
2 **Department and the Legislative Revenue Officer, shall prepare a report regarding the eco-**
3 **nomic impact of sections 2 to 10 of this 2011 Act and shall present the report to those com-**
4 **mittees of the Seventy-seventh Legislative Assembly to which revenue matters are assigned.**
5 **The purpose of the report is to analyze the job creation and tax implications of sections 2**
6 **to 10 of this 2011 Act.**

7 **(b) The confidentiality requirements applicable to tax returns and the information con-**
8 **tained therein is not applicable to the Oregon Business Development Department and the**
9 **Legislative Revenue Officer for purposes of preparing the report described in paragraph (a)**
10 **of this subsection.**

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

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

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