

1 **State of Arkansas**  
2 **78th General Assembly**  
3 **First Extraordinary Session, 1992**  
4 **By: Senator Pagan**

# A Bill

**SENATE BILL**

**Call Item #**

## For An Act To Be Entitled

8 "AN ACT TO BE KNOWN AS THE ENTERPRISE CAPITAL FORMATION  
9 ACT OF 1992."

10  
11 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF ARKANSAS:

12  
13 SECTION 1. This act may be cited as the "Enterprise Capital Formation  
14 Act of 1992."

15  
16 SECTION 2. A taxpayer may elect to receive a tax deduction from the  
17 Arkansas Income Tax Act of 1929, as amended, §26-51-101 et seq. in lieu of the  
18 benefits provided by Arkansas Code 26-51-815.

19  
20 SECTION 3. As used in this Act, references to sections 41, 174, 195,  
21 334, 351, 368, 543, 652, 662, 723, 732, 1563 shall mean those sections of  
22 Title 26 of the United States Code as in effect on January 1, 1991. The  
23 sections are adopted for the purpose of calculating the income tax deduction  
24 allowed under this act.

25  
26 SECTION 4. Deduction for Gain on Certain Small Business Stock.  
27 "(a) General Rule. If a taxpayer has a qualified small business net  
28 capital gain for any income year, there shall be allowed as a deduction from  
29 gross income an amount equal to the sum of:

- 30 (1) 50 percent of the excess (if any) of  
31 (A) qualified small business net capital gain, over  
32 (B) the amount of seed capital gain, plus  
33 (2) the seed capital gain deduction.

34 (b) Qualified Small Business Net Capital Gain. For purposes of this  
35 section, the term qualified small business net capital gain means the lesser

1 of:

- 2 (1) the net capital gain for the income year, or
- 3 (2) the net capital gain for the income year determined by taking
- 4 into account only gain or loss from sales or exchanges of qualified small
- 5 business stock with a holding period of more than 5 years at the time of sale
- 6 or exchange.

7 (c) Seed Capital Gain Deduction. For purposes of this section

8 (1) In General. The term seed capital gain deduction means an  
9 amount equal to the sum of the amounts determined by applying the applicable  
10 percentages to the appropriate categories of seed capital gain under the table  
11 contained in paragraph (2).

12 (2) Computation of Amount. The seed capital gain deduction shall  
13 be computed as follows:

14	The applicable
15 In the case of:	percentage is:
16 5-year gain .....	50
17 6-year gain .....	60
18 7-year gain .....	70
19 8-year gain .....	80
20 9-year gain .....	90
21 10-year gain .....	100

22  
23 (3) Seed Capital Gain. For purposes of this subsection, the term  
24 seed capital gain means the lesser of:

25 (A) the excess (if any) of  
26 (i) the net capital gain for the income year, over  
27 (ii) the qualified small business net capital gain for  
28 the income year determined without regard to gain or loss described in  
29 subparagraph (B), or

30 (B) the net capital gain for the income year determined by  
31 taking into account only gain or loss from sales or exchanges of stock

32 (i) which is qualified small business stock in a  
33 corporation which is a qualified small business (determined by substituting  
34 \$5,000,000 for \$100,000,000 in Section 5 (b) (1), and

35 (ii) with a holding period of more than 5 years at the

1 time of the sale or exchange.

2 (4) Categories of Gain. For purposes of this subsection

3 (A) 10-Year Gain. The term \_10-year gain\_ means the lesser  
4 of:

5 (i) the seed capital gain, or

6 (ii) the seed capital gain determined by taking into  
7 account under paragraph (3)(B) only gain or loss from qualified small business  
8 stock with a holding period of more than 10 years at the time of the sale or  
9 exchange.

10 (B) Other Gain. The terms \_5-, 6-, 7-, 8-, and 9-year  
11 gain\_ mean, with respect to any category, the lesser of:

12 (i) the excess (if any) of

13 (I) seed capital gain, over

14 (II) the amount determined under this paragraph for  
15 categories with a longer holding period, or

16 (ii) seed capital gain determined by taking into  
17 account under paragraph (3)(B) only gain or loss from qualified small business  
18 stock with a holding period of more than 5, 6, 7, 8, or 9 years but not more  
19 than 6, 7, 8, 9, or 10 years, respectively.

20 (d) Estates and Trusts. In the case of an estate or trust, the  
21 deduction under subsection (a) shall be computed by excluding the portion (if  
22 any) of the gains for the income year from sales or exchanges of qualified  
23 small business stock which, under section 652 and 662 (relating to inclusions  
24 of amounts in gross income of beneficiaries of trusts), is includible by the  
25 income beneficiaries as gains derived from the sale or exchange of capital  
26 assets.

27

28 SECTION 5. Definitions and Special Rules.

29 (a) Qualified Small Business Stock. For purposes of this part

30 (1) In General. The term \_qualified small business stock\_ means  
31 any stock in a corporation which is originally issued after December 31, 1991,  
32 if:

33 (A) as of the date of issuance, such corporation is a  
34 qualified small business, and

35 (B) except as provided in subsections (d) and (e), such

1 stock is acquired by the taxpayer at its original issue (directly or through  
2 an underwriter)

3 (i) in exchange for money or other property (not  
4 including stock, or

5 (ii) as compensation for services (other than services  
6 performed as an underwriter of such stock).

7 (2) 5-Year Active Business Requirement. Stock in a corporation  
8 shall not be treated as qualified small business stock unless, during the  
9 testing period, such corporation meets the active business requirements of  
10 subsection (c).

11 (3) Certain Redemptions, Exchanges, Etc. Disqualified. For  
12 purposes of paragraph (1)(B), and except as provided in subsections (d) and  
13 (e), stock shall not be treated as acquired by the taxpayer at its original  
14 issue if:

15 (i) it is issued directly or indirectly in redemption  
16 of, or otherwise in exchange for, stock which is not qualified small business  
17 stock, or

18 (ii) it is issued in an exchange described in section  
19 351 in exchange for property other than qualified small business stock, if  
20 immediately after the exchange, both the issuer and transferee of the stock  
21 are members of the same controlled group of corporations (as defined in  
22 section 1563).

23 (b) Qualified Small Business. For purposes of this part:

24 (1) In General. The term qualified small business means any  
25 domestic corporation with respect to which the sum of

26 (A) the aggregate amount of money, other property, and  
27 services received by the corporation for stock, as a contribution to capital,  
28 and as paid-in surplus, plus

29 (B) the accumulated earnings and profits of the corporation  
30 does not exceed \$100,000,000. The determination under the preceding sentence  
31 shall be made as of the time of such issuance but shall include amounts  
32 received in such issuance and all prior issuances.

33 (2) Amount taken into account with respect to property and  
34 services. For purposes of paragraph (1):

35 (A) Property. The Amount taken into account with respect

1 to any property other than money shall be an amount equal to the adjusted  
2 basis of such property for determining gain, reduced (but not below zero) by  
3 any liability to which the property was subject or which was assumed by the  
4 corporation. The determination under the preceding sentence shall be made as  
5 of the time the property was received by the corporation.

6 (B) Compensation for Services. The amount taken into  
7 account with respect to stock issued for services shall be the value of such  
8 services.

9 (c) Active Business Requirements. For purposes of this part:

10 (1) In General. For purposes of subsection (a) (2), the  
11 requirements of this subsection are met if, during the testing period

12 (A) the corporation is engaged in the active conduct of a  
13 trade or business, and

14 (B) substantially all of the assets of such corporation are  
15 used in the active conduct of a trade or business.

16 (2) Special Rule for Certain Activities. For purposes of  
17 paragraph (1), if, in connection with any future trade or business, a  
18 corporation is engaged in

19 (A) start-up activities described in section 195(c) (1) (A),

20 (B) activities resulting in the payment or incurring of  
21 expenditures which may be treated as research and experimental expenditures  
22 under section 174, or

23 (C) activities with respect to in-house research expenses  
24 described in section 41(b) (4), such corporation shall be treated with respect  
25 to such activities as engaged in (and assets used in such activities shall be  
26 treated as used in) the active conduct of a trade or business. Any  
27 determination under this paragraph shall be made without regard to whether a  
28 corporation has any gross income from such activities at the time of the  
29 determination.

30 (3) Stock in Other Corporations.

31 (A) Look-Thru in Case of Subsidiaries. For purposes of  
32 this subsection, stock and debt in any subsidiary corporation shall be  
33 disregarded and the parent corporation shall be deemed to own its ratable  
34 share of the subsidiary\_s assets, and to conduct its ratable share of the  
35 subsidiary\_s activities.

1 (B) Portfolio Stock. A corporation shall be treated as  
2 failing to meet the requirements of paragraph (1) if, at any time during the  
3 testing period, more than 10 percent of the value of its assets (in excess of  
4 liabilities) consist of stock in other corporations which are not subsidiaries  
5 of such corporation.

6 (C) Subsidiary. For purposes of this paragraph, a  
7 corporation shall be considered a subsidiary if the parent owns at least 50  
8 percent of the combined voting power of all classes of stock entitled to vote,  
9 or at least 50 percent in value of all outstanding stock of such corporation.

10 (4) Working Capital. For purposes of paragraph (1)(B), any  
11 assets which

12 (A) are held for investment, and

13 (B) are to be used to finance future research and

14 experimentation or working capital needs of the corporation, shall be  
15 treated as used in the active conduct of a trade or business.

16 (5) Maximum Real Estate Holdings. A corporation shall not be  
17 treated as meeting the requirements of paragraph (1) if, at any time during  
18 the testing period, more than 10 percent of the total value of its assets is  
19 real property which is not used in the active conduct of a trade or business.  
20 For purposes of the preceding sentence, the ownership of, dealing in, or  
21 renting of real property shall not be treated as the active conduct of a trade  
22 or business.

23 (6) Small business Investment Companies. Paragraph (1) shall not  
24 apply to any small business investment company operating under the Small  
25 Business Investment Act of 1958.

26 (7) Computer Software Royalties. For purposes of paragraph (1),  
27 rights to computer software which produces income described in section 543(d)  
28 shall be treated as an asset used in the active conduct of a trade or  
29 business.

30 (8) Testing Period. For purposes of this section, the term  
31 testing period means, with respect to any stock held by a taxpayer, the 5-  
32 year period beginning with the first day of the taxpayer's holding period for  
33 such stock.

34 (d) Special Rules for Options, Warrants, and Certain Convertible  
35 Investments. For purposes of this part

1 (1) In General. In the case of stock which is acquired by the  
2 taxpayer through the exercise of an applicable option or warrant, through the  
3 conversion of convertible debt, or in exchange for securities of the  
4 corporation in a transaction described in section 368

5 (A) such stock shall be treated as acquired by the taxpayer  
6 at original issue, and

7 (B) such stock shall be treated as having been held during  
8 the period such option, warrant, or debt was held, or such security was  
9 outstanding.

10 (2) Issue Price for Convertible Debt or Security. For purposes  
11 of subsection (b)(1) of this section and notwithstanding subsection (b)(2) of  
12 this section, in the case of a debt instrument converted to stock, or stock  
13 issued in exchange for securities in a transaction described in Section 368,  
14 such stock shall be treated as issued for an amount equal to the sum of

15 (A) the principal amount of the debt or security as of the  
16 time of the conversion or exchange, and

17 (B) accrued but unpaid interest on such loan or security.

18 (3) Applicable option or warrant. For purposes of this  
19 subsection, the term applicable option or warrant means an option or warrant  
20 which

21 (A) was issued in exchange for the performance of services  
22 for the corporation issuing it, and

23 (B) is nontransferable.

24 (e) Certain Tax-Free and other transfers. For purposes of this part

25 (1) In General. In the case of a transfer of stock to which this  
26 subsection applies, the transferee shall be treated as

27 (A) having acquired such stock in the same manner as the  
28 transferor, and

29 (B) having held such stock during any continuous period  
30 immediately preceding the transfer during which it was held (or treated as  
31 held under this subsection) by the transferor.

32 (2) Transfers to which subsection applies. This subsection shall  
33 apply to any transfer

34 (A) by gift,

35 (B) at death,

1 (C) to the extent that the basis of the property in the  
2 hands of the transferee is determined by reference to the basis of the  
3 property in the hands of the transferor by reason of section 334(b), 723, or  
4 732, or

5 (D) of qualified small business stock for other qualified  
6 small business stock in a transaction described in section 351 or a  
7 reorganization described in section 368.

8 (3) Incorporations and Reorganizations Involving Nonqualified  
9 stock.

10 (A) In General. In the case of a transaction described in  
11 section 351 or a reorganization described in section 368, if a qualified small  
12 business stock is transferred for other stock which is not qualified small  
13 business stock, such transfer shall be treated as a transfer to which this  
14 subsection applies solely with respect to the person receiving such other  
15 stock.

16 (B) Limitation. This part shall apply to the sale or  
17 exchange of stock treated as qualified small business stock by reason of  
18 subparagraph (A) only to the extent of the gain (if any) which would have been  
19 recognized at the time of the transfer described in subparagraph (A) if  
20 section 351 or 368 had not applied at such time.

21 (C) Successive Application. For purposes of this  
22 paragraph, stock treated as qualified small business stock under subparagraph  
23 (A) shall be so treated for subsequent transactions or reorganizations, except  
24 that the limitation of subparagraph (B) shall be applied as of the time of the  
25 first transfer to which subparagraph (A) applied.

26 (D) Control Test. Except in the case of a transaction  
27 described in section 368, this paragraph shall apply only if, immediately  
28 after the transaction, the corporation issuing the stock owns directly or  
29 indirectly stock representing control (within the meaning of section 368(c) of  
30 the corporation whose stock was transferred.

31 (f) Stock Exchanged for Property. For purposes of this part, in the  
32 case where the taxpayer transfers property (other than money or stock) to a  
33 corporation in exchange for stock in such corporation

34 (1) such stock shall be treated as having been acquired by the  
35 taxpayer on the date of such exchange, and

1 (2) the basis of such stock in the hands of the taxpayer shall be  
2 treated as equal to the fair market value of the property exchanged.

3 (g) Pass-Thru Entities. For purposes of this part, any gain or loss of  
4 a pass-thru entity which is treated for purposes of this subtitle as a gain or  
5 loss of any person holding an interest in such entity shall retain its  
6 character as qualified small business or seed capital gain or loss in the  
7 hands of such person.

8 (h) Indexing. In the case of any stock issued in a calendar year after  
9 1992, the \$5,000,000 and \$100,000,000 amounts in Section 4(c)(3)(B)(i) and  
10 subsection (b)(1) of this section shall be increased by an amount equal to

- 11 (1) such dollar amount, multiplied by
  - 12 (2) the cost-of-living adjustment determined under section
- 13 1(f)(3) for such calendar year by substituting 1991 for 1987 in  
14 subparagraph (B) thereof.

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16 SECTION 6. (a) This act shall apply to income years beginning after  
17 December 31, 1991.

18 (b) This act shall apply to stock issued after December 31, 1991.

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20 SECTION 7. All provisions of this Act of a general and permanent  
21 nature are amendatory to the Arkansas Code of 1987 Annotated and the Arkansas  
22 Code Revision Commission shall incorporate the same in the Code.

23

24 SECTION 8. If any provision of this Act or the application thereof to  
25 any person or circumstance is held invalid, such invalidity shall not affect  
26 other provisions or applications of the Act which can be given effect without  
27 the invalid provision or application, and to this end the provisions of this  
28 Act are declared to be severable.

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30 SECTION 9. All laws and parts of laws in conflict with this Act are  
31 hereby repealed.

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