

111TH CONGRESS  
2D SESSION

# H. R. 5864

To amend the Internal Revenue Code of 1986 to allow a credit against income tax for qualified equity investments in certain small businesses, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

JULY 26, 2010

Mr. SESTAK introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to allow a credit against income tax for qualified equity investments in certain small businesses, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Small Business Inno-  
5 vation through Investment Act of 2010”.

6 **SEC. 2. EQUITY INVESTMENT IN SMALL BUSINESS TAX**  
7 **CREDIT.**

8 (a) IN GENERAL.—Subpart D of part IV of sub-  
9 chapter A of chapter 1 of the Internal Revenue Code of

1 1986 (relating to business related credits) is amended by  
2 adding at the end the following new section:

3 **“SEC. 45R. EQUITY INVESTMENT IN SMALL BUSINESS TAX**  
4 **CREDIT.**

5 “(a) GENERAL RULE.—

6 “(1) IN GENERAL.—For purposes of section 38,  
7 in the case of a qualified investor, the equity invest-  
8 ment in small business tax credit determined under  
9 this section for the taxable year is an amount equal  
10 to 30 percent of the amount of each qualified equity  
11 investment made by the qualified investor during the  
12 taxable year.

13 “(2) YEARS IN WHICH CREDIT ALLOWABLE.—  
14 The credit under paragraph (1) shall be allowable as  
15 follows:

16 “(A) Fifty percent of such credit shall be  
17 allowed in the taxable year in which the quali-  
18 fied equity investment is made.

19 “(B) Twenty-five percent of such credit  
20 shall be allowed in the taxable year after the  
21 taxable described in subparagraph (A).

22 “(C) Twenty-five percent of such credit  
23 shall be allowed in the second taxable year after  
24 the taxable described in subparagraph (A).

1       “(b) CREDIT AMOUNT.—For purposes of determining  
2 the small business tax credit under subsection (a), the  
3 amount of qualified equity investments made by the quali-  
4 fied investor during the taxable year shall not exceed  
5 \$500,000, reduced by so much of \$250,000 that is not  
6 an investment in—

7               “(1) small business concerns in manufacturing  
8 and biotechnology,

9               “(2) minority and women-owned small busi-  
10 nesses, or

11               “(3) a qualified HUBzone small business con-  
12 cern (as defined in section 3(p)(5) of the Small  
13 Business Act (15 U.S.C. 632(p)(5))).

14       “(c) DEFINITIONS.—For purposes of this section—

15               “(1) QUALIFIED INVESTOR.—The term ‘quali-  
16 fied investor’ means—

17                       “(A) an individual who qualifies as an ac-  
18 credited investor under rules and regulations  
19 prescribed by the Commissioner of the Securi-  
20 ties and Exchange Commission, or

21                       “(B) a partnership with respect to which  
22 all of the partners are individuals who qualify  
23 as accredited investors under rules and regula-  
24 tions prescribed by the Commissioner of the Se-  
25 curities and Exchange Commission.

1           “(2) QUALIFIED EQUITY INVESTMENT.—The  
2           term ‘qualified equity investment’ means the trans-  
3           fer of cash or cash equivalents in exchange for stock  
4           or capital interest in a qualified small business.

5           “(3) QUALIFIED SMALL BUSINESS.—The term  
6           ‘qualified small business’ means a private small busi-  
7           ness concern (within the meaning of section 3 of the  
8           Small Business Act)—

9                   “(A) that meets the applicable size stand-  
10                  ard (as in effect on January 1, 2005) estab-  
11                  lished by the Administrator of the Small Busi-  
12                  ness Administration pursuant to subsection  
13                  (a)(2) of such section, and

14                  “(B) has its principal place of business in  
15                  the United States.

16           For purposes of this section, all members of the  
17           same controlled group of corporations (within the  
18           meaning of section 267(f)) and all persons under  
19           common control (within the meaning of section  
20           52(b)) shall be treated as 1 qualified small business.

21           “(d) ACTIVE BUSINESS REQUIREMENT.—

22                  “(1) IN GENERAL.—Holding stock in a quali-  
23                  fied small business shall not be treated as a qualified  
24                  equity investment unless, during substantially all of  
25                  the qualified investor’s holding period for such stock,

1 such qualified small business meets the active busi-  
2 ness requirements of paragraph (2).

3 “(2) REQUIREMENTS.—

4 “(A) IN GENERAL.—For purposes of para-  
5 graph (1), the requirements of this paragraph  
6 are met by a qualified small business for any  
7 period if during such period at least 80 percent  
8 (by value) of the assets of such qualified small  
9 business are used by such qualified small busi-  
10 ness in the active conduct of 1 or more quali-  
11 fied trades or businesses.

12 “(B) SPECIAL RULE FOR CERTAIN ACTIVI-  
13 TIES.—For purposes of subparagraph (A), if, in  
14 connection with any future qualified trade or  
15 business, a qualified small business is engaged  
16 in—

17 “(i) start-up activities described in  
18 section 195(c)(1)(A),

19 “(ii) activities resulting in the pay-  
20 ment or incurring of expenditures which  
21 may be treated as research and experi-  
22 mental expenditures under section 174, or

23 “(iii) activities with respect to in-  
24 house research expenses described in sec-  
25 tion 41(b)(4),

1        assets used in such activities shall be treated as  
2        used in the active conduct of a qualified trade  
3        or business. Any determination under this sub-  
4        paragraph shall be made without regard to  
5        whether a qualified small business has any  
6        gross income from such activities at the time of  
7        the determination.

8            “(C) QUALIFIED TRADE OR BUSINESS.—  
9        For purposes of this paragraph, the term  
10       ‘qualified trade or business’ is as defined in sec-  
11       tion 1202(e)(3).

12           “(D) STOCK IN OTHER ENTITIES.—

13           “(i) LOOK-THRU IN CASE OF SUBSIDI-  
14       ARIES.—For purposes of this subsection,  
15       stock and debt in any subsidiary entity  
16       shall be disregarded and the parent quali-  
17       fied small business shall be deemed to own  
18       its ratable share of the subsidiary’s assets,  
19       and to conduct its ratable share of the sub-  
20       sidiary’s activities.

21           “(ii) PORTFOLIO STOCK OR SECURI-  
22       TIES.—A qualified small business shall be  
23       treated as failing to meet the requirements  
24       of subparagraph (A) for any period during  
25       which more than 10 percent of the value of

1 its assets (in excess of liabilities) consists  
2 of stock or securities in other entities  
3 which are not subsidiaries of such qualified  
4 small business other than assets described  
5 in subparagraph (E)).

6 “(iii) SUBSIDIARY.—For purposes of  
7 this subparagraph, an entity shall be con-  
8 sidered a subsidiary if the parent owns  
9 more than 50 percent of the combined vot-  
10 ing power of all classes of stock entitled to  
11 vote, or more than 50 percent in value of  
12 all outstanding stock, of such entity.

13 “(E) WORKING CAPITAL.—For purposes of  
14 subparagraph (A), any assets which—

15 “(i) are held as a part of the reason-  
16 ably required working capital needs of a  
17 qualified trade or business of the qualified  
18 small business, or

19 “(ii) are held for investment and are  
20 reasonably expected to be used within 2  
21 years to finance research and experimen-  
22 tation in a qualified trade or business or  
23 increases in working capital needs of a  
24 qualified trade or business,

1 shall be treated as used in the active conduct of  
2 a qualified trade or business. For periods after  
3 the qualified small business has been in exist-  
4 ence for at least 2 years, in no event may more  
5 than 50 percent of the assets of the qualified  
6 small business qualify as used in the active con-  
7 duct of a qualified trade or business by reason  
8 of this subparagraph.

9 “(F) MAXIMUM REAL ESTATE HOLD-  
10 INGS.—A qualified small business shall not be  
11 treated as meeting the requirements of subpara-  
12 graph (A) for any period during which more  
13 than 10 percent of the total value of its assets  
14 consists of real property which is not used in  
15 the active conduct of a qualified trade or busi-  
16 ness. For purposes of the preceding sentence,  
17 the ownership of, dealing in, or renting of real  
18 property shall not be treated as the active con-  
19 duct of a qualified trade or business.

20 “(G) COMPUTER SOFTWARE ROYALTIES.—  
21 For purposes of subparagraph (A), rights to  
22 computer software which produces active busi-  
23 ness computer software royalties (within the  
24 meaning of section 543(d)(1)) shall be treated



1 as an asset used in the active conduct of a  
2 trade or business.

3 “(e) CERTAIN PURCHASES BY QUALIFIED INVESTOR  
4 OF ITS OWN STOCK.—

5 “(1) REDEMPTIONS FROM QUALIFIED INVES-  
6 TOR OR RELATED PERSON.—Stock acquired by the  
7 qualified investor shall not be treated as a qualified  
8 equity investment if, at any time during the 4-year  
9 period beginning on the date 2 years before the  
10 issuance of such stock, the qualified small business  
11 issuing such stock purchased (directly or indirectly)  
12 any of its stock from the qualified investor or from  
13 a person related (within the meaning of section  
14 267(b) or 707(b)) to the qualified investor.

15 “(2) SIGNIFICANT REDEMPTIONS.—Stock  
16 issued by a qualified small business to a qualified in-  
17 vestor shall not be treated as a qualified equity in-  
18 vestment if, during the 2-year period beginning on  
19 the date 1 year before the issuance of such stock,  
20 such qualified small business made 1 or more pur-  
21 chases of its stock with an aggregate value (as of the  
22 time of the respective purchases) exceeding 5 per-  
23 cent of the aggregate value of all of its stock as of  
24 the beginning of such 2-year period.

1           “(3) TREATMENT OF CERTAIN TRANS-  
2 ACTIONS.—If any transaction is treated under sec-  
3 tion 304(a) as a distribution in redemption of the  
4 stock of any qualified small business, for purposes of  
5 subparagraphs (A) and (B), such qualified small  
6 business shall be treated as purchasing an amount  
7 of its stock equal to the amount treated as such a  
8 distribution under section 304(a).

9           “(f) SPECIAL RULE FOR RELATED PARTIES.—

10           “(1) IN GENERAL.—No credit shall be allowed  
11 under subsection (a) with respect to a qualified eq-  
12 uity investment made by a qualified investor in a  
13 qualified small business that is a related party to the  
14 qualified investor.

15           “(2) RELATED PARTY.—For purposes of para-  
16 graph (1), a person is a related party with respect  
17 to another person if such person bears a relationship  
18 to such other person described in section 267(b) or  
19 707(b), or if such persons are engaged in trades or  
20 businesses under common control (within the mean-  
21 ing of subsections (a) and (b) of section 52).

22           “(g) RECAPTURE OF CREDIT IN CERTAIN CASES.—

23           “(1) IN GENERAL.—If, at any time during the  
24 3-year period beginning on the date that the quali-  
25 fied equity investment is made by the qualified in-

1 investor, there is a recapture event with respect to  
2 such investment, then the tax imposed by this chap-  
3 ter for the taxable year in which such event occurs  
4 shall be increased by the credit recapture amount.

5 “(2) CREDIT RECAPTURE AMOUNT.—For pur-  
6 poses of paragraph (1), the credit recapture amount  
7 is an amount equal to the sum of—

8 “(A) the aggregate decrease in the credits  
9 allowed to the taxpayer under section 38 for all  
10 prior taxable years which would have resulted if  
11 no credit had been determined under this sec-  
12 tion with respect to such investment, plus

13 “(B) interest at the underpayment rate es-  
14 tablished under section 6621 on the amount de-  
15 termined under subparagraph (A) for each  
16 prior taxable year for the period beginning on  
17 the due date for filing the return for the prior  
18 taxable year involved.

19 No deduction shall be allowed under this chapter for  
20 interest described in subparagraph (B).

21 “(3) RECAPTURE EVENT.—For purposes of  
22 paragraph (1), there is a recapture event with re-  
23 spect to a qualified equity investment if such invest-  
24 ment is sold, transferred, or exchanged by the quali-  
25 fied investor, but only to the extent that such sale,

1 transfer, or exchange is not the direct result of a  
2 complete or partial liquidation of the qualified small  
3 business in which such qualified equity investment is  
4 made.

5 “(4) SPECIAL RULES.—

6 “(A) TAX BENEFIT RULE.—The tax for  
7 the taxable year shall be increased under para-  
8 graph (1) only with respect to credits allowed  
9 by reason of this section which were used to re-  
10 duce tax liability. In the case of credits not so  
11 used to reduce tax liability, the carryforwards  
12 and carrybacks under section 39 shall be appro-  
13 priately adjusted.

14 “(B) NO CREDITS AGAINST TAX.—Any in-  
15 crease in tax under this subsection shall not be  
16 treated as a tax imposed by this chapter for  
17 purposes of determining the amount of any  
18 credit under this chapter or for purposes of sec-  
19 tion 55.

20 “(h) BASIS REDUCTION.—The basis of any qualified  
21 equity investment shall be reduced by the amount of any  
22 credit determined under this section with respect to such  
23 investment.

24 “(i) REGULATIONS.—

1           “(1) IN GENERAL.—The Secretary shall pre-  
 2       scribe such regulations as necessary to carry out the  
 3       provisions of this section.

4           “(2) CERTIFICATION OF QUALIFIED EQUITY IN-  
 5       VESTMENT.—Such regulations shall require that a  
 6       qualified investor—

7               “(A) certify that the small business in  
 8               which the equity investment is made meets the  
 9               requirements described in subsection (c)(3), and

10               “(B) include the name, address, and tax-  
 11              payer identification number of such small busi-  
 12              ness on the return claiming the credit under  
 13              subsection (a).

14       “(j) TERMINATION.—This section shall not apply to  
 15       qualified equity investments made in taxable years begin-  
 16       ning after December 31, 2016.”.

17       (b) CREDIT MADE PART OF GENERAL BUSINESS  
 18       CREDIT.—Subsection (b) of section 38 of such Code is  
 19       amended by striking “and” at the end of paragraph (34),  
 20       by striking the period at the end of paragraph (35) and  
 21       inserting “, and”, and by adding at the end the following  
 22       new paragraph:

23               “(36) in the case of a taxpayer, the equity in-  
 24              vestment in small business tax credit determined  
 25              under section 45R(a).”.

1 (c) CLERICAL AMENDMENT.—The table of sections  
 2 for subpart D of part IV of subchapter A of chapter 1  
 3 of such Code is amended by adding at the end the fol-  
 4 lowing new item:

“Sec. 45R. Equity investment in small business tax credit.”.

5 (d) EFFECTIVE DATE.—The amendments made by  
 6 this section shall apply to qualified equity investments  
 7 made after December 31, 2010, in taxable years beginning  
 8 after such date.

9 **SEC. 3. ADMINISTRATOR OF SMALL BUSINESS ADMINISTRA-**  
 10 **TION.**

11 (a) DATA COLLECTION.—The Secretary of the Treas-  
 12 ury shall provide to the Administrator of the Small Busi-  
 13 ness Administration any data—

14 (1) available to the Secretary on the implemen-  
 15 tation and use of the equity investment in small  
 16 business tax credit determined under section 45R of  
 17 the Internal Revenue Code of 1986; and

18 (2) requested by the Administrator for analysis  
 19 purposes.

20 (b) REPORT.—Not later than 1 year after the date  
 21 of enactment of this Act and annually thereafter during  
 22 the 5-year period beginning on such date, the Adminis-  
 23 trator of the Small Business Administration shall submit  
 24 to Congress a report describing the implementation and  
 25 use of the equity investment in small business tax credit

- 1 determined under section 45R of the Internal Revenue
- 2 Code of 1986.

