State of North Carolina

CORPORATE INCOME, FRANCHISE, AND INSURANCE TAX BULLETIN

Reflecting Changes Made in the 2016 Regular Session of the North Carolina General Assembly

Issued by:

Corporate Tax Division
Tax Administration
North Carolina Department of Revenue
501 North Wilmington Street
Raleigh, North Carolina 27604

June 2017

PREFACE

The Corporate Income, Franchise, and Insurance Tax Bulletin was prepared for the purpose of presenting the administrative interpretation and application of North Carolina corporate income, franchise, and insurance premiums tax laws at the time of publication. This publication supplements information provided in the Administrative Rules but does not supersede the Administrative Rules. In addition, this bulletin does not cover all provisions of the law.

Taxpayers are cautioned that this publication is intended merely as a guide and that consideration must be given to all the facts and circumstances in applying this Bulletin to particular situations. Taxpayers using this publication should be aware that additional changes may result from legislative action, court decisions, and rules adopted or amended under the Administrative Procedure Act, Chapter 150B of the General Statutes. To the extent there is any change to a statute, administrative rule, or new case law subsequent to the date of this publication, the provisions in this bulletin may be superseded or voided. Unless otherwise noted, this Bulletin is intended to reflect changes made in the 2016 regular session of the North Carolina General Assembly.

Revised June 2017

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I. FRANCHISE TAX
(Article 3)

A. General Information (G.S. 105-114)

1. Scope and Nature

North Carolina levies a series of franchise taxes upon corporations, both domestic and foreign, and upon certain persons, limited liability companies ("LLCs"), and partnerships. The taxes levied in this subchapter are for the privilege of engaging in business or doing the act named. Specific sections of the law under which the various corporations and businesses are taxed are as follows:

G.S. § 105-114.1	Limited liability companies
G.S. § 105-120.2	Holding companies
G.S. § 105-122	General business corporations
G.S. § 105-125	Exempt corporations

The taxes levied upon corporations organized under the laws of North Carolina (domestic corporations) are for the corporate rights and privileges granted by their charters, and the enjoyment of corporate powers, rights, privileges and immunities under the laws of North Carolina.

The taxes levied upon corporations not organized under the laws of North Carolina (foreign corporations) are for the privilege of doing business in this State and for the benefit and protection they receive from the government and laws of this State.

A corporation, other than a holding company taxed under G.S. § 105-120.2, that is subject to one of the franchise taxes other than the general business franchise tax, is subject to the general business franchise tax to the extent it exceeds the other franchise tax.

2. Corporation Defined

For franchise tax purposes, the term "corporation" includes not only corporations in the usual meaning of the term, but also associations, joint stock companies, trusts and other organizations formed or operating for pecuniary gain which have capital stock represented by shares and privileges not possessed by individuals or partnerships. The term includes limited liability companies that elect to be taxed as corporations for federal income tax purposes.

3. S Corporations

S corporations are liable for franchise tax levied under Article 3 of the Revenue Laws.

4. Period Covered

Taxes levied under this Article are for the fiscal year of the State in which they become due, except that the taxes levied are for the income year of the corporation in which such taxes become due.

5. Inactive Corporations (17 NCAC 05B.0104)

A corporation that is inactive and without assets is subject to an annual minimum franchise tax of two hundred dollars ($200). Failure to file this return and pay the minimum tax will result in the suspension of the Articles of Incorporation or Certificate of Authority. Any corporation that intends to dissolve or withdraw through suspension for nonpayment of franchise tax should indicate its intention in writing to the Department.

6. Voluntary Dissolution or Withdrawal of Corporate Rights (G.S. § 105-127(d))

Corporations are not subject to franchise tax after the end of the income year in which articles of dissolution or withdrawal are voluntarily filed with the Secretary of State unless they engage in business activities not reasonably incidental to winding up their affairs. Therefore, no franchise tax is required with the income tax return filed for the year in which the application is filed or with any subsequent income tax returns that may be required in connection with winding up the affairs of the corporation.

> Example 1: A calendar year corporation voluntarily files articles of dissolution or withdrawal during the calendar year 2017. Although its final income tax return will be filed on a franchise and income tax return, the franchise tax portion of the return need not be completed since the franchise tax applicable to calendar year 2017 was calculated on the 2016 tax return.

> Example 2: A corporation using an income year ending April 30 voluntarily files articles of dissolution or withdrawal on May 19, 2017. Although its final income tax return will be filed on a franchise and income tax return, the franchise tax portion of the return need not be completed since the franchise tax applicable to the income year beginning May 1, 2017, was calculated on the tax return for the income year ended April 30, 2017.

A corporation is not entitled to a partial refund of franchise tax paid if the corporation files articles of dissolution or withdrawal during the year.

7. Payment of Franchise Taxes (G.S. § 105-122(a))

Franchise tax is due on the statutory filing date of the return, without regard to extensions.

8. Extension of Filing Date (17 NCAC 05B.0107)

A corporation subject to the franchise tax may obtain an extension of time for filing its franchise tax return by filing Form CD-419 within the time required pursuant to G.S. § 105-263. Form CD-419 is available at: http://www.dor.state.nc.us/downloads/corporate.html.

An extension of time for filing a franchise tax return does not extend the time for paying the tax due or the time when a penalty attaches for failure to pay the tax. For additional detailed information concerning the requirements for obtaining an extension of time for filing a corporate franchise and income tax return, *see "Extension of Time for Filing Return"* in **Section II, Corporate Income Tax**.

9. Tax Credit for Limited Liability Companies Subject to Franchise Tax (G.S. § 105-122.1)

LLCs that elect to be taxed as corporations for federal income tax purposes are allowed a tax credit against franchise tax equal to the difference between the annual report fee on corporations for filing paper annual reports under G.S. **§** 55-1-22(a)(23) and the annual report fee for limited liability companies under G.S. **§** 57D-1-22. The credit allowed may not exceed the franchise tax liability for the year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

Example. An LLC that has elected to be taxed as a corporation computes its franchise tax due to be $500. Because the fee under for an LLC under G.S. **§** 57D-1-22 is $200, while the fee for a corporation filing a paper annual report under G.S. **§** 55-1-22(a)(23) is $25, a credit of $175 is allowed to the LLC against franchise tax.

B. Holding Companies (G.S. § 105-120.2)

1. Definition

A holding company is any corporation that receives more than eighty percent (80%) of its gross income during its taxable year from corporations in which it owns, directly or indirectly, more than fifty percent (50%) of the outstanding voting stock or voting capital interest. A corporation will also qualify for holding company status if it has no assets other than ownership interests in corporations in which it owns, directly or indirectly, more than 50% of the outstanding stock or voting capital interests.

If a holding company has an ownership interest in an LLC doing business in the State and the LLC is taxed as a corporation for federal income tax purposes, the holding company's share of the income of the LLC is included in the denominator and, if the corporation owns more than fifty percent (50%) of the voting capital interest in the LLC, the holding company's share of the income of the LLC is included in the numerator when computing the holding company test.

2. Basis for Taxation

The basis of the tax for a holding company is the same as for general business corporations. However, franchise tax payable by a qualified holding company on its net worth base is limited to one hundred and fifty thousand dollars ($150,000). Any corporation that qualifies as a holding company for franchise tax should fill in the circle next to Line 1 on Page 1 of the appropriate form, CD-405 or CD-401S. There is no limitation on the amount of franchise tax payable where the tax produced by the investment in tangible property or appraised value of property exceed the tax produced by the net worth base.

C. General Business Corporations (G.S. § 105-122)

1. Basis for the Tax

For years beginning on or after January 1, 2017, the basis of the tax is the net worth of the taxpayer. The basis is the same for both domestic and foreign corporations. Corporations doing business both within and without North Carolina are required to apportion their net worth to North Carolina in accordance with a specified statutory apportionment formula. Regardless of the actual amount of net worth, the amount determined for purposes of this tax cannot be less than fifty-five percent (55%) of appraised ad valorem tax value of all the real and tangible property in North Carolina or less than the actual investment in tangible property in North Carolina.

2. Franchise Tax Calculation

Franchise tax is calculated on the largest of the following amounts:

- The net worth tax base
- Fifty-five percent (55%) of appraised ad valorem tax value of all real and tangible property in N. C.
- Actual investment in tangible property in North Carolina

3. Corporations Required to File

Unless specifically exempt under G.S. § 105-125, all active and inactive domestic corporations, and all foreign corporations with a Certificate of Authority to do business, or which are in fact doing business in this State, are subject to the annual franchise tax levied under G.S. § 105-122.

If an LLC is taxed as a corporation for federal tax purposes and a corporate member's only connection to North Carolina is its ownership interest in the LLC, the corporate member(s) is not required to file a North Carolina corporate income and franchise tax return. The corporate member(s) is not required to file in this circumstance because the LLC reports its North Carolina income at the entity level and the apportionment attributes of the LLC do not flow through to the corporate member(s) as is the case when the LLC is disregarded or is treated as a partnership.

If an LLC is taxed as a corporation for federal tax purposes and a corporate member has activities in this State in addition to its ownership interest in the LLC, the corporate member(s) is required to file a corporate income and franchise tax return.

4. Forms to be Used for Filing

The franchise tax is filed on Form CD-405 for C corporations and Form CD-401S for S corporations. These forms, along with other required corporate forms and instructions, are available from the Department's web site at:

http://www.dor.state.nc.us/downloads/corporate.html.

5. Substitute Returns

Any substitute form must be approved by the Department of Revenue prior to its use. The guidelines for producing substitute forms are available on the Department's website. If a taxpayer uses computer-generated returns, the software company is responsible for requesting and receiving an assigned barcode. The Department publishes a list of software developers that have received approval on the Department's web site. Photocopies of the return are not acceptable. Returns that cannot be processed by our imaging and scanning equipment may be returned to the taxpayer with instructions to refile on an acceptable form.

6. Report and Payment Due

Corporations must file returns annually on or before the fifteenth day of the fourth month following the end of the income year. The return is filed as a part of a joint franchise and income tax return. Payment of the entire amount of franchise tax is required by the statutory due date of the return.

7. Tax Rate

The franchise tax rate is one dollar and fifty cents ($1.50) per one thousand dollars ($1,000) and is applied as set forth in the law. The minimum franchise tax is two hundred dollars ($200).

8. Franchise Tax Payable in Advance (G.S. § 105-114)

Franchise tax is payable in advance for the privilege of doing business in North Carolina or for the privilege of existing as a corporation in North Carolina.

Example: A corporation incorporates, domesticates or commences business in North Carolina on October 15, 2016. The corporation has selected a calendar year end. The first tax return due on April 15, 2017 will be a short period return covering the income tax period from October 15, 2016 to December 31, 2016. Franchise tax due on this return covers the ensuing calendar year through December 31, 2017 for the privilege of doing business in North Carolina or for the privilege of existing as a corporation in North Carolina.

D. Net Worth Base (G.S. § 105-122(b)) – (Applicable to Tax Years Beginning On or After January 1, 2017 calculated on 2016 and after income tax returns)

1. Based on Year End Balance Sheet

Net worth is measured as of the end of the taxable year using generally accepted accounting principles ("GAAP"). If the corporation does not use GAAP in maintaining its books and records, then net worth is computed using the same accounting method used for federal income tax purposes, so as long as this method fairly represents the corporation's net worth for franchise tax purposes.

2. Net Worth Defined

A corporation's net worth is defined as the total assets of the corporation without regard to deductions for accumulated depreciation, depletion, or amortization ***minus*** total liabilities.

3. Adjustments to Net Worth

In determining net worth, the following adjustments are required:

(a) A deduction for accumulated depreciation, depletion, or amortization allowed for federal income tax purposes.

(b) A deduction for the cost of treasury stock.

(c) An addition for the amount of affiliated indebtedness owed to a parent, subsidiary, affiliate, or noncorporate entity if the corporation or affiliated group directly or indirectly owns 50% or more of the noncorporate entity, other than debt that is merely endorsed, guaranteed or otherwise supported by the corporation or affiliated group of corporations.

The addition for affiliated indebtedness may be reduced based on the ratio of the borrowed capital over the total assets of the creditor corporation. Borrowed capital does not include indebtedness incurred by a bank from a deposit evidenced by a certificate of deposit, passbook, cashier's check, certified check, or similar document or record.

(d) A creditor corporation that is subject to franchise tax may deduct the amount of indebtedness owed to it by a parent, subsidiary, or affiliated corporation to the extent such indebtedness has been added by the debtor corporation in computing its franchise tax liability.

4. Other Definitions

In determining the net worth base, the following definitions apply:

(a) Affiliate – A corporation is an affiliate of another corporation if it is controlled directly or indirectly by the same parent corporation or same or associated financial interests through stock ownership, interlocking directors, or by any other means whatsoever, whether the control is direct or through one or more subsidiary, affiliate, or controlled corporation.

(b) Affiliated Group – The same meaning as defined in G.S. § 105-114.1.

(c) Capital Interest – The right under the entity's governing law to receive a percentage of the entity's assets, after payments to creditors, if the entity were dissolved.

(d) Governing Law – The law under which the noncorporate entity was organized.

(e) Indebtedness – All loans, credits, goods, supplies, or other capital of whatsoever nature furnished by a parent, a subsidiary, an affiliate, or a noncorporate entity in which the corporation or an affiliated group of corporations owns directly or indirectly more than 50% of the capital interests of the noncorporate entity. Indebtedness does not include amount endorsed, guaranteed, or otherwise supported by one of the related corporations.

(f) Noncorporate entity – a person that is neither a human being nor a corporation.

(g) Parent – A corporation that directly or indirectly controls another corporation by stock ownership, interlocking directors, or by any other means whatsoever exercised by the same or associated financial interests, whether such control is direct or through one or more subsidiary, affiliated, or controlled corporations.

(h) Subsidiary – A corporation that is directly or indirectly subject to control by another corporation by stock ownership, interlocking directors, or by any other means whatsoever exercised by the same or associated financial interest, whether the control is direct or through one or more subsidiary, affiliated, or controlled corporations.

(i) Total assets – The sum of all cash, investments, furniture, fixtures, equipment, receivables, intangibles, and any other items of value owned by a person or a business entity.

E. Multistate Corporations (G.S. § 105-122(c1))

1. Apportionment Formula

Every corporation permitted to apportion its net income for income tax purposes under the provisions of G.S. § 105-130.4 must apportion its net worth for franchise tax purposes through use of the same fraction computed for apportionment of its apportionable income under G.S. § 105-130.4. A corporation that is subject to the general business franchise tax, but exempt from income tax, must apportion its net worth by using the apportionment factor it would have used had it been subject to the income tax. Adjustments in the method of apportionment authorized by the Secretary of Revenue for apportionment of net income do not apply automatically to apportionment of net worth. Unless the Secretary specifically authorizes a modified method of allocation for franchise tax purposes, the statutory formula must be used.

2. Alternate Apportionment Formula

If any corporation believes that the statutory apportionment formula allocates more of its net worth to North Carolina than is reasonably attributable to its business in this State, it may make a written request to the Secretary of Revenue for permission to use an alternative formula which it believes is a better method to apportion its net worth to North Carolina.

The written request must be made with the Secretary not later than ninety (90) days after the regular or extended due date of the tax return. Taxpayers should address all correspondence in connection with such petitions to the Secretary of the Revenue.

The Secretary must issue a written decision on a corporation's request for an alternative apportionment method. The decision can apply to no more than three years. If the request is denied, the Secretary's decision is final and is not subject to administrative or judicial review. A corporation authorized to use an alternative formula may apportion its net worth base using the alternative method or the statutory method.

F. Investment in Tangible Property in North Carolina Base (G.S. § 105-122(d))

1. Basis For the Investment Base

This base includes the original purchase price plus additions and improvements and less reserve for depreciation permitted for income tax purposes of all tangible property, including real estate located in North Carolina at the end of the income year immediately preceding the due date of the return.

2. What is Includable in the Investment Base (17 NCAC 05B.1302)

Include all tangible assets located in North Carolina at original purchase price less reserve for depreciation permitted for income tax purposes. In addition to the types of property listed in the schedule, include all other tangible property owned such as supplies and tools. Typical items of tangible property would include: inventory (valued at actual cost or by method consistent with the actual flow of goods), consigned inventories to be included by consignor, machinery and equipment, furniture and fixtures, containers, tools and supplies, land, buildings, leasehold improvements, and all other tangible assets.

3. Treatment of Construction in Progress (17 NCAC 05B.1303)

Construction in progress is excluded from this base only if such property is not owned by the corporation filing the return.

4. Determination of Inclusion Based on Depreciation Deduction (17 NCAC 05B.1309)

When two or more corporations are in doubt as to which should include property, including leased property, in the investment in tangible property base, such property shall be included by the corporation allowed depreciation under the Federal Code.

5. Holding Company

There is no limitation on the franchise tax payable by a holding company on its investment in tangible property tax base.

G. Appraised Valuation of Tangible Property Base (G.S. § 105-122(d), 17 NCAC 05B.1406)

Tangible property values for this base are computed on fifty-five percent (55%) of the appraised value of all property listed for county ad valorem tax in North Carolina as of January 1 of the calendar year next preceding the due date of the return.

Note: Also included in the appraised value of property for county ad valorem tax is the appraised value of all vehicles for which the county tax assessor has issued a billing during the income year.

There is no limitation on the franchise tax payable by a holding company on its appraised valuation of property tax base.

H. Corporate Members of LLCs (G.S. § 105-114.1)

(This section does not apply to limited liability companies that are taxed as corporations, but does apply to noncorporate limited liability companies, i.e., limited liability companies that do not elect to be taxed as corporations under the Code.)

If a corporation or affiliated group of corporations owns, directly or constructively, more than fifty percent (50%) of the capital interests in an LLC, the corporation or group of corporations must include the same percentage of the LLC's assets in its three franchise tax bases. In that case, the corporation's investment in the LLC is not included in the calculation of the corporation's capital stock, surplus and undivided profits base. The attribution to the three bases is equal to the same percentage of (1) the LLC's capital stock, surplus and undivided profits, (2) fifty-five percent (55%) of the LLC's appraised ad valorem tax value of property, and (3) the LLC's actual investment in tangible property in this State.

Exception – if the total book value of the LLC's assets never exceeds one hundred fifty thousand dollars ($150,000) during its taxable year, no attribution is required.

When a partnership, trust, LLC, or other entity is placed between a corporation and an LLC, ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in IRC § 318(a)(2)(A) and (B), modified as follows:

- The term "capital interest" is substituted for "stock" where that term appears in the referenced Code section.
- An LLC and any entity other than a partnership, estate or trust is treated as a partnership.

- The operating rule of section 318(a)(5) applies without regard to section 318(a)(5)(C).

Example: A partnership owns one hundred percent (100%) of the capital interests of an LLC. Corporation A is a fifty percent (50%) owner of the partnership. Corporation A constructively owns fifty percent (50%) of the capital interest in the LLC.

The members of an affiliated group must determine the percentage of the LLC’s assets to be included in each member’s franchise tax bases. If all members of the group are doing business in North Carolina, then the percentage of the LLC’s assets included by each member in its franchise tax bases is equal to the member’s percentage ownership in the LLC. If some of the members of the group are not doing business in North Carolina, then the percentage of the LLC’s assets owned by the group are allocated among the members that are doing business in North Carolina. The percentage attributed to each member doing business in North Carolina is determined by multiplying the percentage of the LLC owned by the entire group by a fraction. The numerator of the fraction is the percentage of the LLC owned by the member and the denominator is the total percentage of the LLC owned by all members doing business in North Carolina.

If the owner of the capital interests in an LLC is an affiliated group of corporations, the percentage to be included by each member that is doing business in this State is determined by multiplying the capital interests in the LLC owned by the affiliated group by a fraction. The numerator of the fraction is the capital interests of the LLC owned by the group member, and the denominator is the capital interests in the LLC owned by all group members that are doing business in this State.

Ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in IRC § 318(a)(2)(A) and (B), modified as follows:

- The term “capital interest” is substituted for “stock” where that term appears in the referenced Code section.
- A LLC and any entity other than a partnership, estate, or trust is treated as a partnership.
- The operating rule of section 318(a)(5) of the Code applies without regard to section 318(a)(5)(C).

Example: An affiliated group of corporations own one hundred percent (100%) of the capital interests in an LLC. The group consists of three corporations. Corporation A is doing business in North Carolina and owns fifty percent (50%) of the LLC. Corporation B is doing business in North Carolina and owns ten percent (10%) of the LLC. Corporation C is not doing business in North Carolina and owns forty percent (40%) of the LLC. The percentage of the LLC’s assets required to be included in Corporation A’s and Corporation B’s franchise tax bases is determined as follows:

Corporation A: 100% X 50% ÷ (50% + 10%) = 83.33%

Corporation B: 100% X 10% ÷ (50% + 10%) = 16.67%

A corporation that is required to include a percentage of the LLC's assets in its franchise tax computation may exclude its investment in the LLC from its computation of the net worth base.

Shifting assets back and forth between a corporation and an LLC to avoid franchise tax is prohibited. Ownership of the capital interests in an LLC is determined as of the last day of the LLC's taxable year. The attribution of the LLC's assets and the exclusion of the corporation's investment in the LLC are made to the corporation's next following franchise tax return. However, if the corporation and LLC engage in a pattern of transferring assets between them so that each did not own the assets on the last day of its taxable year, the ownership of the capital interest in the LLC must be determined as of the last day of the corporation's taxable year.

Any taxpayer who, because of fraud with intent to evade tax, underpays the tax under this Article (G.S. 105 Article 3) is guilty of a Class H felony in accordance with G.S. 105-236(7). For additional information on the filing requirements for members of LLCs, see Item 5, Subsection J *"Corporations Conditionally or Partially Exempt."*

I. Change of Income Year (105-122(e))

1. Computation of Tax (17 NCAC 05B.1501)

A change in income year automatically establishes a new franchise year. A joint franchise and income tax return is required for the short income period. Credit is permitted on such return against the franchise tax to the extent that the new franchise year overlaps the old year.

Example: A corporation changes its income year from a calendar year to one ending July 31. A combined franchise and income return is required for the short period January 1, 2017 through July 31, 2017 (seven (7) months). Franchise tax paid on the 2016 return applicable to the calendar year 2017 was $240. Franchise tax on the short period would be applicable to the year August 1, 2017 through July 31, 2018, and would be computed as follows:

Total tax due per return		$268
Less credit for portion of prior year's tax:		
Total tax paid on 2006 return	$240	
Less amount applicable to short period (7/12 of $240)	140	
Amount applicable beyond short period	100	
Net franchise tax due on short period return		$168

G.S. § 105-129.5(b) applies in computing the net franchise tax due for the short period. The statutorily computed tax is reduced by current installments and carryforwards of available tax credits, subject to the fifty percent (50%) limitation, before calculating the amount applicable to the short period and the amount applicable beyond the short period.

2. Computation of Tax When Merger is Involved (17 NCAC 05B.1502)

Often when two corporations merge, a question arises concerning which corporation is liable for the franchise tax. If the merger is effective at any time after the close of the submerged corporation's year-end, then the submerged corporation is liable for the tax. If the merger is effective at any time prior to the close of the submerged corporation's year-end, then the surviving corporation is liable for the tax.

Since franchise tax is paid prospectively, a special computation is sometimes required to prevent a duplication of tax when two or more corporations with different income years merge or otherwise transfer the entire assets from one corporation to the other. The following example illustrates the conditions under which this occurs.

Example: ABC Corporation, whose income year ends July 31, merged into XYZ Corporation, whose income year is the calendar year. The merger occurred on October 31, 2016. ABC filed a combination franchise and income tax return for the year ended July 31, 2016 and paid franchise tax of six hundred dollars ($600) applicable to the ensuing year ending July 31, 2017. XYZ filed a combination franchise and income tax return for the calendar year 2016 and paid franchise tax of seven hundred dollars ($700) applicable to the ensuing calendar year 2017. The assets reflected in ABC's tax base were also reflected in XYZ's tax base since they had been transferred to XYZ in the merger, and therefore, were on its books as of the end of its income year, December 31, 2016. The year to which ABC's payment applied overlapped the year to which XYZ's payment applied by seven months (January 1, 2017 through July 31, 2017) and reflected a duplication of tax to that extent.

When the conditions illustrated in the above example exist, where, the acquiring corporation acquired the entire assets of the disposing corporation, the acquiring and disposing corporations had different income years, the date of merger or transfer was after the end of the disposing corporation's income year next preceding such transfer but before the beginning of the surviving corporation's income year next following such transfers, and the disposing corporation had paid franchise tax applicable to its income year in which the transfer occurred, the acquiring corporation may compute its franchise tax on its franchise and income tax return for the income year in which the transfer occurred as shown in the following example:

Franchise tax per surviving corporation's return for income year in which transfer occurred				$700
Less: Franchise tax paid by submerged corporation per return for income year immediately preceding transfer			$600	
Number of months between the ending dates on the above returns / Number of months in year	5 / 12	x $600 =	250	
Amount pertaining to overlapping months			$350	
Net franchise tax due				$350

J. Corporations Conditionally or Partially Exempt (G.S. § 105-122, G.S. § 105-125)

1. Non-Profit Organizations

The following organizations and any other organization exempt from federal income tax under the Code are exempt from franchise tax if they are not organized for profit and if no profit inures to the benefit of any member, shareholder or other individual:

a. Fraternal societies, orders or associations. To qualify for income tax exemption, the organization must operate under the lodge system or for the exclusive benefit of members of a fraternity that is operating under the lodge system, and provide life, sick, accident or other benefits to the members or their dependents.

b. Corporations organized or trusts created for religious, charitable, scientific or educational purposes, including cemetery corporations and organizations for the prevention of cruelty to children and animals.

c. Business leagues, chambers of commerce, merchants associations and boards of trade.

d. Civic leagues or organizations operated exclusively for the promotion of civic welfare.

e. Clubs organized and operated exclusively for pleasure, recreation and other non-profit purposes.

f. Mutual hail, cyclone and fire insurance companies; mutual ditch, irrigation, canning and breeding associations; mutual or cooperative telephone companies; and like organizations of a purely local character which derive their entire income from assessments, dues or fees collected from members for the sole purpose of meeting expenses.

g. Farmer's marketing associations operating as sales agents to market the products of members or other farmers, and to return to them the proceeds, less the necessary selling expenses, on the basis of the quantity of product furnished by them.

h. Pension, profit-sharing, stock bonus and annuity trusts established by employers for the purpose of distributing both the principal and income thereof exclusively to eligible employees or the beneficiaries of such employees. There must be no discrimination in favor of any particular employee. The interest of individual employees must be irrevocable and nonforfeitable to the extent of contributions by such employees. Exemption of a trust under the Federal income tax law is a prima facie basis for granting exemption from North Carolina franchise and income taxation.

i. Condominium associations, homeowner associations or cooperative housing corporations not organized for profit, the membership of which is limited to the owners or occupants of residential units in the condominium, housing development, or cooperative housing corporation.

j. Cooperative or mutual associations formed under Section 54-124 of the General Statutes to conduct agricultural business on the mutual plan, and marketing associations formed under Section 54-129 of the General Statutes, are exempt from franchise tax.

2. Corporations Fully Exempt

These corporations qualify for the full franchise tax exemption:

- Insurance companies subject to the tax on gross premiums are exempt from the general business franchise tax.
- Telephone membership corporations organized under Chapter 117 of the General Statutes of North Carolina are exempt from the general business franchise tax. Electric membership corporations are, however, subject to franchise tax.

3. Regulated Investment Companies (RIC) and Real Estate Investment Trusts (REIT)

These organizations are required to pay franchise tax; however, in determining net worth they are allowed to deduct the aggregate market value of investments in the stock, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments. Captive REITs are not allowed this deduction. A captive REIT is a REIT whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are owned or controlled, at any time during the last half of the tax year, by a person that is subject to tax under this Part and is not a trust or another entity that qualifies as a real estate investment trust under section 856 of the Code or a listed Australian property.

4. Real Estate Mortgage Investment Conduits (REMIC)

These organizations are exempt from franchise tax to the extent the REMIC is exempt from income tax under the Code.

5. Limited Liability Company (LLC)

The "North Carolina Limited Liability Company Act" (Chapter 57C of the North Carolina General Statutes) permits the organization and operation of limited liability companies (LLC). An LLC is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership. Noncorporate limited liability companies are not subject to the franchise tax. A noncorporate limited liability company is an LLC that does not elect to be taxed as a corporation under the Code.

II. CORPORATE INCOME TAX
(Article 4 – Part 1)

A. Corporations Subject to Tax, Tax Rate and Allocation Requirements (G.S. §§ 105-130.3 and 105-130.4)

1. Domestic and Foreign Corporations Required to File (17 NCAC 05C.0101)

All domestic corporations (those organized in North Carolina), and all foreign corporations (those organized outside North Carolina) with a certificate of authority to do business or doing business in North Carolina, are subject to income tax and are required to file annual income tax returns, except corporations specifically exempt from the tax under G.S. § 105-130.11, and S corporations exempt under G.S. § 105-131.1.

Because of a difference between the State income tax laws and the laws under the North Carolina Business Corporation Act, a foreign corporation operating in North Carolina may be liable for income tax even if not be required to obtain a certificate of authority to do business in North Carolina. For example, a Virginia corporation engaged in the general contracting business, which obtains a single, isolated job in North Carolina to be completed within six months, may not be required to obtain a certificate of authority to do business in this State under the Business Corporation Act but would be subject to income tax.

Note: A corporation organized in North Carolina or with a certificate of authority to do business in North Carolina must file an income tax return as a matter of record, even if the corporation was inactive or did not earn any net income in the tax year.

2. "Doing Business" Defined (17 NCAC 05C.0102)

For income tax purposes, the term "doing business" means the operation of any business enterprise or activity in North Carolina for economic gain, including, but not limited to, the following:

a. The maintenance of an office or other place of business in North Carolina;

b. The maintenance in North Carolina of an inventory of merchandise or material for sale, distribution or manufacture, regardless of whether kept on the premises of the taxpayer or in a public or rented warehouse;

c. The selling or distributing of merchandise to customers in North Carolina directly from a company-owned or operated vehicle when title to the merchandise is transferred from the seller or distributor to the customer at the time of the sale or distribution;

d. The rendering of a service to clients or customers in North Carolina by agents or employees of a foreign corporation; or

e. The owning, renting, or operating of business or income producing property in North Carolina including, but not limited to, the following:

- Realty;
- Tangible personal property;
- Trademarks, trade names, franchise rights, computer programs, copyrights, patented processes, licenses.

Corporations who are partners in a partnership or joint venture operating in North Carolina are considered to be "doing business" in the State.

"Doing business" by an interstate motor carrier is defined as the performance of any of the following business activities in North Carolina:

- The maintenance of an office in the State;
- The operation of a terminal or other place of business in the State;
- Having an employee working out of the office or terminal of another company;
- Dropping off or gathering up shipments in the State.

3. Corporations Operating in Interstate Commerce (17 NCAC 05C.0103)

The fact that a foreign corporation's activities or operations in North Carolina are a part of its overall interstate business does not exempt the corporation from income tax liability. A corporation doing business in North Carolina as outlined above is subject to income tax even if its only operations in this State are a part of its interstate business. A foreign corporation not domesticated in North Carolina whose only activity in this State is the solicitation of sales of tangible personal property by either resident or nonresident salesmen is not required to file income tax returns under the Department's current policy. However, if such a corporation maintains an office or other place of business in North Carolina, owns business property in this State, or meets the doing business definition, it is subject to the tax.

4. Tax Rate and Basis for the Tax (G.S. § 105-130.3, G.S. § 105-130.3C, G.S. § 105-130.4)

An income tax is levied on the State net income of all corporations chartered or doing business in North Carolina unless they are specifically exempt from tax under G.S. §§ 105-130.11 and 105-131.1. State net income is taxable income as defined in the Internal Revenue Code ("Code") in effect for the income year for which the returns are to be filed, subject to the adjustments provided in G.S. § 105-130.5. The rates are as provided below:

Tax Year Beginning on or after	Tax Rate
1/1/2014	6.0%
1/1/2015	5.0%
1/1/2016	4.0%
1/1/2017	3.0%

In the case of a corporation that has business operations both within and without North Carolina; its net taxable income shall be allocated and apportioned to this State in accordance with G.S. § 105-130.4.

5. Corporations Required to Allocate and Apportion Income (G.S. § 105-130.4, 17 NCAC 05C.0601 and .0701)

A corporation must have business income from North Carolina and at least one other state to apportion and allocate its income. When a corporation is only taxable in another state as a result of nonapportionable income, then all apportionable income is attributed to North Carolina.

A corporation taxable both within and without North Carolina is required to use the allocation and apportionment provisions of G.S. § 105-130.4 to calculate its net income or net loss to North Carolina. For purposes of allocation and apportionment, a corporation is taxable in another state if:

- The corporation's business activity in that state subjects it to a net income tax or a tax measured by net income; or
- That state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless of whether that state exercises its jurisdiction.

"Business activity" includes any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code, Section 381 (P.L. 86-272), based on North Carolina standards for doing business in this State. The filing of a unitary-combined return in another state with other related corporations does not, by itself, constitute "business activity" for purposes of determining if a corporation subject to income tax in this state is allowed to allocate and apportion income.

6. When in Doubt as to Liability

Any foreign corporation operating in North Carolina that is not certain of its tax status should promptly apply to the Department for a determination of its status. Complete detailed information as to the corporation's operations should be submitted. All correspondence concerning the matter should be addressed to the Voluntary Disclosure Program, N.C. Department of Revenue, P.O. Box 871, Raleigh, N.C. 27602-0871.

7. Tax Forms

Corporation tax returns, Form CD-405 or Form CD-401S, are available from the Department's web site at:

http://www.dornc.com/downloads/corporate.html.

B. Tax Credits

Taxpayers are allowed various tax credits in Chapter 105 of the General Statutes that could be used to reduce corporate income tax (for credits applicable to Franchise Tax, see the **Franchise Tax** section of the 2017 Technical Bulletins). The following is a list of income tax credits that were repealed effective for tax years beginning on or after January 1, 2015:

- Credit for Rehabilitating Income-Producing Historic Structure - G.S. § 105-129.35
- Credit for Rehabilitating Nonincome-Producing Historic Structure - G.S. § 105-129.36
- Credit for Low Income Housing Awarded a Federal Credit Allocated on or after January 1, 2003 - G.S. § 105-129.42
- Credit for Income-Producing Rehabilitated Mill Property - G.S. § 105-129.71
- Credit for Nonincome-Producing Rehabilitated Mill Property - G.S. § 105-129.72
- Credit for Qualifying Expenses of a Production Company - G.S. §§ 105-130.47 and 105-151.29

These credits expired for tax years beginning on or after January 1, 2015.

- Credit for Investing in Renewable Energy Property - G.S. § 105-129.16A
- Credit for Donating to a Nonprofit Organization to Acquire Renewable Energy Property - G.S. § 105-129.16H
- North Carolina Research & Development - G.S. § 105-129.55

These credits expired for tax years beginning on or after January 1, 2016.

- Credit for Manufacturing Cigarettes for Exportation - G.S. § 105-130.45
- Credit for Manufacturing Cigarettes for Exportation While Increasing Employment and Utilizing State Ports - G.S. § 105-130.46

This credit will expire for tax years beginning on or after January 1, 2018.

- Credit for Constructing a Railroad Intermodal Facility - G.S. § 105-129.96

This credit will expire for tax years beginning on or after January 1, 2038.

For more specific information on these and the **Article 3L Credit for Rehabilitation Income and Non-Income Producing Historic Property**, see the **Tax Credits** section of the 2017 Technical Bulletins.

C. Computation of Net Income (G.S. §§ 105-130.3 and G.S. 105-130.5)

1. Preliminary Statement

A corporation uses its federal taxable income, as defined in the Code in effect for the tax year for which the return is to be filed, as its beginning point and adds or deducts the items listed below to compute State net income or loss.

A corporation may attach a copy of its Federal income tax return and supporting schedules in lieu of completing the corresponding schedules in its State return.

2. Adjustments to Federal Taxable Income

The following ***additions*** to Federal taxable income must be made in determining State net income:

a..Taxes based on or measured by net income by whatever name called and excess profits taxes.

b. Interest paid in connection with income exempt from State income taxation. *See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."*

c. The contributions deduction allowed by the Internal Revenue Code.

d. Interest income earned on bonds and other obligations of other states or their political subdivisions, less allowable amortization on any bond acquired on or after January 1, 1963.

e. The amount by which gains have been offset by the capital loss carryover allowed under the Internal Revenue Code. All gains recognized on the sale or other disposition of assets are included in determining State net income or loss in the year of disposition.

f. Any amount allowed as a net operating loss deduction allowed by the Internal Revenue Code.

g. Payments to or charges by a parent, subsidiary or affiliated corporation in excess of fair compensation in any intercompany transaction.

h. The amount of all income tax credits claimed against the corporation's income tax liability during the income year. In lieu of the add-back of tax credits to federal taxable income, taxpayers must reduce the amount of credit available by the current income tax rate. See Form CD-425, available at:

http://www.dor.state.nc.us/downloads/corporate.html.

i. Percentage depletion in excess of cost depletion applicable to mines, oil and gas wells and other natural deposits located outside this State.

j. The amount allowed under the Code for depreciation or as an expense in lieu of depreciation for a utility plant acquired by a natural gas local distribution company, to the extent the plant is included in the company's rate base at zero cost in accordance with G.S. § 62-158.

k. Royalty payments for the use of intangible property in this State made to a related member and deducted as an expense by a payer in arriving at federal taxable income if the election is made under G.S. § 105-130.7A for the recipient to exclude the royalty income from its income. A taxpayer making this election does not relieve the recipient from filing a North Carolina income tax return or apportioning royalty income pursuant to G.S. 105-130.4.

For purposes of G.S. § 105-130.7A, intangible property is defined as copyrights, patents, and trademarks. A taxpayer is not required to add back royalty payments for the use of intangible property in this State to a related recipient if the related recipient is organized under the laws of another country, that country has a comprehensive income tax treaty with the United States, and that country imposes a tax on the royalty income of the recipient at a rate that is equal to or exceeds the State's corporate income tax rate.

l. The gross income from international shipping activities excluded from federal taxable income because the corporation elects to be subject instead to a tonnage tax under subchapter R of Chapter 1 of the Code.

m. The gross income from domestic production activities excluded from federal taxable income under section 199 of the Code.

n. The dividends paid deduction allowed to a captive Real Estate Investment Trust ("REIT"). A captive REIT is one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to North Carolina corporate income tax. REITs owned by other REITs or listed Australian property trusts are excluded from the definition.

o. The amount of a donation to a nonprofit organization or a unit of State or local government for acquisition or lease of renewable energy property made by a taxpayer who claimed a tax credit under G.S. § 105-129.16H.

p. The amount of income deferred under section 108(i)(1) of the Code from discharge of indebtedness in connection with a reacquisition of an applicable debt instrument.

q. The amount allowed as a deduction under section 163(e)(5)(F) of the Code for an original issue discount on an applicable high yield discount obligation.

r. The amount required to be added under G.S. § 105-130.5B when the State decouples from federal accelerated depreciation and expensing. *See section 4, Adjustments When State Decouples From Bonus Depreciation and Section 179 Expenses*.

s. The amount of net interest expense as determined under G.S. § 105-130.7B.

The following ***deductions*** from Federal taxable income must be made in determining State net income:

a. Interest from obligations of the United States or its possessions, net of related expenses, to the extent included in federal taxable income. However, interest on obligations of the United States shall not be an allowable deduction unless interest from obligations of the State of North Carolina or any of its political subdivisions is exempt from income tax imposed by the United States.

b. Interest (net of expenses) received from obligations of the State of North Carolina, a political subdivision of this State, a commission, authority, or another agency of this State, a nonprofit educational institution organized or chartered under the laws of this State, and a hospital authority created under G.S. § 131E-17, to the extent the amounts are included in federal taxable income.

c. Payments received from a parent, subsidiary, or affiliated corporation in excess of fair compensation in intercompany transactions which were not allowed as a deduction for North Carolina income tax purposes by such corporation(s).

d. Dividends treated as received from sources outside the United States, as determined under section 862 of the Code, net of related expenses, to the extent included in federal taxable income. The netting of related expenses is calculated in accordance with G.S. §§ 105-130.5(c)(3) and 105-130.6A.

e. Any amount included in federal taxable income under section 78 or section 951 of the Code, net of related expenses.

f. For years prior to those beginning on or after January 1, 2015, net economic losses incurred by the corporation in any or all of the fifteen (15) preceding years pursuant to the provisions of G.S. § 105-130.8. For tax years beginning on or after January 1, 2015, state net losses are calculated under the provisions of G.S. § 105-130.8A. For specific instructions with respect to net economic loss and state net loss determinations *see Subject: "State Net Loss Deduction and Net Economic Loss Carry-Over."*

g. Contributions or gifts made by the corporation within the income year to the extent provided under G.S. § 105-130.9. *See Subject: "Deduction of Contributions."*

h. The amount of losses realized on the sale or other disposition of assets not allowed under section 1211(a) of the Internal Revenue Code. All losses recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.

i. The portion of undistributed capital gains of regulated investment companies included in federal taxable income and on which the federal tax paid by the regulated investment company is allowed as a credit or refund to the shareholder under section 852 of the Internal Revenue Code.

j. The amount by which the basis of a depreciable asset has been reduced on account of a tax credit allowed for federal tax purposes or a Section 1603 grant.

k. The amount of natural gas expansion surcharges collected by a natural gas local distribution company under G.S. § 62-158.

l. To the extent included in federal taxable income, the amount of 911 charges imposed under G.S. § 62A-43 and remitted to the 911 Fund under that section.

m. Royalty payments received for the use of intangible property in this State by a recipient from a payer that is a related member, if the election is made under G.S. § 105-130.7A for the payer to exclude the royalty payments from its expenses deduction. For purposes of G.S. § 105-130.7A, intangible property is defined as copyrights, patents, and trademarks.

n. The amount of dividend received from a captive Real Estate Investment Trust. A captive REIT is one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to NC corporate income tax. REITs owned by other REITs or listed Australian property trusts are excluded from the definition.

o. The amount of deferred income added to federal taxable income under IRC section 108(i)(1).

p. The amount allowed as a deduction under G.S. § 105-130.5B resulting from the add-back of federal income tax accelerated depreciation or expensing of assets. *See section 4, Adjustments When State Decouples from Bonus Depreciation and Expensing*.

q. The amount of qualified interest expense to a related member as determined under G.S. § 105-130.7B.

Other adjustments to Federal taxable income that must be made in determining State net income are listed below:

a. In determining State net income, no deduction shall be allowed for annual amortization of bond premiums applicable to any bond acquired prior to January 1, 1963. The amount of premium paid on any such bond shall be deductible only in the year of sale or other disposition.

b. Federal taxable income must be increased or decreased to account for any difference in the amount of depreciation, amortization, or gains or losses applicable to property that has been depreciated or amortized by use of a different basis or rate for State income tax purposes than used for federal income tax purposes prior to January 1, 1967.

c. No deduction is allowed for any direct or indirect expenses related to income not taxed, except no adjustment is made under this subsection for adjustments addressed in G.S. §§ 105-130.5(a) and (b). *See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."*

d. Federal taxable income must be adjusted in instances where the taxable income change caused by the recovery of previously deducted amounts may be different for state income tax purposes.

e. Depreciation recapture under Federal provisions must also be included in State net income. Since depreciation recapture is included in the corporation's federal taxable income, no adjustment is necessary in computing its State net income.

3. Unrealized Income from Installment Sales Taxable upon Termination of Business

A corporation that withdraws, dissolves, merges, or consolidates its business, or terminates its business in this State by any other means whatsoever is required to file a final income tax return within one hundred five (105) days after the close of business. If the corporation uses the installment method of reporting income, all unrealized or unreported income from installment sales made while doing business in this State must be included in State net income on the final return.

4. Adjustments When State Decouples from Bonus Depreciation and Section 179 Expensing (G.S. § 105-130.5B)

a. General

North Carolina law differs from the Code with respect to bonus depreciation under sections 168(k) and (n). In addition, adjustments may be required for amounts deducted under section 179 of the Code. For tax years beginning on or after January 1, 2013 taxpayers are required to make a bonus asset basis adjustment if an asset is transferred and the tax basis of the asset carries over from the transferor to the transferee for federal income tax purposes.

b. Bonus Depreciation Deduction

Taxpayers cannot deduct the full amount of bonus depreciation deduction for federal income tax purposes in the year allowed under sections 168(k) and (n). Instead (except for property placed into service in 2009 discussed below), taxpayers are required to add back eighty-five percent (85%) of the federal bonus deprecation in the year taken for federal income tax. Taxpayers may deduct 20% of the total amount of bonus depreciation added to federal taxable income in each of the first five taxable years following the year the taxpayer is required to include the add-back into income. Thus, the federal bonus depreciation deduction is spread over six taxable years for North Carolina income tax purposes.

Taxpayers that placed property in service in 2009 and took bonus depreciation under section 168(k) in 2009 are required to treat these amounts as placed into service in 2010, and add-back 85% of the bonus depreciation taken in the 2009 tax year to it federal taxable income for the 2010 income tax year. Subsequently, beginning with for tax year 2011, taxpayers are allowed to deduct 20% of the amount of bonus depreciation added to taxable income in each of the first five taxable years following the year the taxpayer is required to include the add-back in income for the five tax years following 2010.

The adjustments do not result in a basis difference for federal and State income tax purposes, except as discussed in *Section d*, below.

c. Section 179 Expenses

For tax years 2010 through 2014, North Carolina did not entirely conform to section 179 expensing allowed for federal income tax purposes. Instead, North Carolina had separate dollar and investment limitations, as follows:

Tax Year	NC Dollar Limitation	NC Investment Limitation
2010	$ 250,000	$ 800,000
2011	$ 250,000	$ 800,000
2012	$ 250,000	$ 800,000

For tax years beginning on or after 2013, the NC Dollar Limitation is $25,000 and the NC Investment Limitation is $200,000.

Taxpayers placing section 179 property into service during these years are required to add to federal taxable income 85% of the section 179 deductions in excess of the amount allowed using the North Carolina limits. Taxpayers may subsequently deduct 20% of the amount of bonus depreciation added to taxable income in each of the first five taxable years following the year the taxpayer is required to include the add-back into income.
The adjustments do not result in a basis difference for federal and State income tax purposes, except as discussed in *Section d*, below.

For additional information regarding section 179 expenses, see:

http://www.dornc.com/taxes/individual/impnotice062014.pdf

d. Bonus Asset Basis Adjustments

A bonus asset basis adjustment is required when the following occurs:

a) There is an actual or deemed transfer of an asset occurring on or after January 1, 2013; and

b) The tax basis of the transferred asset carries over from the transferor to the transferee (i.e., the taxpayer) for federal income tax purposes.

To make an asset basis adjustment, a taxpayer must add any remaining bonus depreciation deductions associated with the transferred asset to the basis of the transferred asset and depreciate the adjusted basis over the remaining life of the asset. The remaining life of the asset is the remaining years in the asset's federal recovery period, as determined under section 168(c) of the Code.

In addition, upon disposition of the asset, adjusted gross income must be increased or decreased to account for any differences in the basis for State and federal income tax purposes.

For examples and additional information of bonus asset basis adjustments, please refer to the **Individual Income Tax Bulletin, Section IV**, and “Bonus Asset Basis” at:

http://www.dornc.com/taxes/bonus_asset.html.

D. Interest Income on Government Obligations (G.S. § 105-130.3, G.S. § 105-130.5)

1. North Carolina Obligations (17 NCAC 05C.0401)

Net interest income received by a corporation on obligations of the State of North Carolina and any of its cities, towns or counties is exempt from income taxes imposed by this State.

For examples of North Carolina obligations exempt from corporate income tax on interest income and gains, see www.dornc.com/taxes/individual/ncobligations.html.

2. Obligations of Other States (17 NCAC 05C.0402)

Net interest income earned by a corporation on its investments in obligations issued by states and their political subdivisions, other than the State of North Carolina, represents taxable income and is subject to this State’s income tax.

3. U.S. Obligations (17 NCAC 05C.0403)

Net interest income earned on bonds, notes or other obligations of the United States or its possessions is exempt from income taxation in this State so long as interest on obligations of the state of North Carolina and its political subdivisions is exempt from income taxes imposed by the United States.

For detailed information on U.S. obligations exempt from tax, see:

www.dornc.com/taxes/individual/usnc.html.

4. Sales or Exchanges (17 NCAC 05C.0404)

Gain or loss realized on the sale or other disposition of any type of obligation of the United States or its possessions, the State of North Carolina or its political subdivisions, any other state or its political subdivisions, or of any other government is a taxable transaction and must be included in the computation of a corporation’s State taxable income.

Gain or loss realized on the sale or other disposition of obligations of the State of North Carolina or its political subdivisions issued before July 1, 1995 is not included in taxable income if North Carolina law under which the obligations were issued specifically exempts the gain or interest from taxation.

For examples of North Carolina obligations exempt from corporate income tax on interest income and gains, see:

www.dornc.com/taxes/individual/ncobligations.html.

5. Obligations of Federal National Mortgage Association (17 NCAC 05C.0405)

Interest income or other income realized on obligations of Federal National Mortgage Association is taxable income.

6. Mortgage Backed Certificate Guaranteed by Federal Agencies (17 NCAC 05C.0406)

Interest paid by the issuer to the holder of a mortgage backed certificate guaranteed by the Federal Government, corporations formed by the Federal Government and/or Federal Agencies is not income from an obligation of the United States Government and is taxable.

7. Repurchase Agreements (17 NCAC 05C.0407)

Income attributable to or received from repurchase agreements of U.S. government securities, an agreement to repurchase securities at an agreed price and date, is not considered income derived directly from federal obligations and is taxable income.

E. Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property (G.S. § 105-130.4, G.S. § 105-130.5, 17 NCAC 05C.0304)

1. Direct Expenses

All expenses directly connected with the production of income not subject to tax in this State are required to be used to compute the net amount of such untaxed income.

2. Interest Expense

When a corporation earns income which is not taxed by this State (see examples), and/or holds property that does or will produce untaxed income, and incurs interest expense, **which is not specifically related to any particular income or property,** it must attribute a portion of the interest expense to such untaxed income and property in determining taxable income reported to this State. The formula for computing the amount of interest expense to be attributed to untaxed income and property is as follows:

a. Assets

i. Value on the tax return balance sheet of assets that produce or which would produce untaxed income. (When the equity method of accounting is used, the increase or decrease in value as result of such accounting may be excluded from this value.)

ii. Value of all assets on the tax return balance sheet. (Equity included in this value may be excluded and the reserve for depreciation reflected on the balance sheet may be restored to the asset value.)

iii. Determine the ratio or percentage of *i* to *ii*

b. Income

i. Gross Untaxed Income
ii. Total Gross Profits
iii. Determine the ratio or percentage of *i* to *ii*

c. Total of the ratios or percentages determined in *a* and *b* above.

d. Divide total of *c* by 2

e. Apply average percentage determined in *d* to the total interest expense on the return filed in this State.

Examples of untaxed income:

- Dividend income not taxed, including dividends excluded by section 243 of the Code and dividends classified as nonapportionable (G.S. §§ 105-130.4, 105-130.5(c)(3))
- Interest income classified as nonapportionable (G.S. § 105-130.4)
- Interest income earned on obligation of the United States and the State of North Carolina.
- Other nonapportionable income and/or exempt income

3. Expense Connected With Interest Income From United States Obligations

Under G.S. § 105-130.5(b)(1), interest income from obligations of the United States or its possessions is excludable from North Carolina taxable income to the extent such income is included in federal taxable income. Since federal taxable income is in effect a net income, expenses incurred in producing the exempt income must be determined and subtracted from the gross amount earned during a taxable period before the deduction is made in computing the state taxable income. The basis for requiring this adjustment to exempt income is based on federal case law. (*First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583, 84 L. Ed. 2d 535 (1985) and supported by an advisory opinion of the North Carolina Attorney General.)

In the computation of expenses related to income from United States obligations, the formula described above in Item 2 may be used with respect to interest expense.

4. Dividends (G.S. §§ 105-130.5(b)(3a) and (c)(3))

For tax years beginning on or after January 1, 2016, expenses attributed to dividends not tax for North Carolina income tax purposes cannot exceed 15%.

5. Other Expenses Attributed to Nontaxable Income and to Nonapportionable Income and Property

In the determination of expenses other than interest expense attributed to untaxed income, the methodologies set forth in the Code for determining expenses related to foreign source income generally referred to as stewardship and supportive expenses may be used to determine the expenses allocated to untaxed income and property producing or which would produce untaxed income.

Alternatively, an income formula as outlined in Item 2 above may be used to determine the amount of supportive function expenses attributable to untaxed income. In determining "supportive function expenses", direct expenses incurred exclusively in a specific identifiable taxable or nontaxable activity should be excluded before applying the attribution percentage to expenses. If direct expenses are determinable for a particular activity resulting in an accurate computation of the net income or loss from such activity, the values of this activity are removed from the two ratios when computing the attribution percentage.

F. Related Entity Interest Deduction Limitation (G.S. § 105-130.7B)

1. Preliminary Statement

For tax years beginning on or after January 1, 2016, a corporation may only deduct the amount of qualified interest expense from a related member, as defined in G.S. § 105-130.7A, unless an exception applies.

2. Qualified Interest Expense

Qualified interest expense is the greater of the amount of interest paid or accrued from a related member up to 15% of the taxpayer's adjusted taxable income as computed without a deduction for related party interest unless an exception applies, or the taxpayer's proportional share of interest. The 15% limitation does not apply to amounts that qualify for an exception under G.S. § 105-130.7B(4).

A taxpayer's proportionate share of interest is

a. The amount paid or accrued directly to or through a related member to an ultimate payer, divided by

b. The total net interest expense of all related members paid or accrued directly through a related member to the same ultimate payer, multiplied by

c. The interest amount paid or accrued by the ultimate payer to an unrelated party. Amounts distributed, paid, or accrued through a related member that is not treated as interest for North Carolina income tax purposes does not qualify.

The ultimate payer is the related member that receives or accrues interest directly or indirectly from other related members and pays or accrues interest to an unrelated entity.

3. Exceptions

The 15% limitation does not apply if

a. An income tax is imposed by North Carolina on the amount of interest income received by the related member;

b. An income or gross receipts tax is imposed by another state on the related member with respect to the interest income;

c. The related member is an entity organized under the laws of a foreign country that has a comprehensive tax treaty with the United States and taxes the interest income at a rate equal to or greater than provided under G.S. § 105-130.3; or

d. The related member is a bank. For the purposes of this section, a bank includes a bank holding company as defined in the Bank Holding Company Act of 1956; a bank, savings bank, savings and loan association, or trust company, as each is defined in G.S. §§ 53C, 54B, and 54C; or a subsidiary or affiliate of any of these entities.

G. Allocation and Apportionment Procedures (G.S. § 105-130.4)

1. Preliminary Statement

A corporation that is taxable both within and without North Carolina is required to allocate and apportion its entire net income or loss to North Carolina in accordance with the statutory formula under G.S. § 105-130.4.

No corporation is allowed to use any alternative formula or method of reporting its income to North Carolina except upon written order of the Secretary of Revenue. Any return in which any formula or method other than as prescribed by statute is used without the permission of the Secretary is not a lawful return.

2. Alternate Apportionment Formula (17 NCAC 05D.0107-.0115)

If a C corporation, S corporation, or limited liability company electing to be taxed as either a C or S corporation for federal income tax purposes, believes that the statutory apportionment formula subjects a greater portion of its income than is reasonably attributable to business or earnings in this State, it may make a written request with the Secretary of Revenue for permission to use an alternate apportionment formula. The request must set out the reasons for the corporation's belief and propose an alternative method. The corporation has the burden of proof for demonstrating why the statutory method subjects it to taxation on a greater proportion of income than is reasonable attributable to North Carolina.

The written request must be made with the Secretary not later than ninety (90) days after the regular or extended due date of the tax return. Taxpayers should address all correspondence in connection with such petitions to the Secretary of Revenue, Department of Revenue, PO Box 871, Raleigh, NC 27602-0871. The Secretary will schedule a conference to hear the corporation's request. The Secretary and the Director of the Income Tax Division and/or their designee(s) will attend the conference. The taxpayer is not required to appear or be represented at the conference; however, an authorized representative may appear on behalf of, or in addition to, the taxpayer.

The Secretary must issue a written decision on a corporation's request for an alternative apportionment method within sixty days from the date of the conference or sixty days after the date any requested additional information is provided. The decision can apply to no more than three years. A corporation may renew a request to use an alternative apportionment method by reapplying to the Secretary of Revenue. A corporation authorized to use an alternative formula may apportion its Net Worth base using the alternative method or the statutory method.

If the Secretary finds the statutory method does not fairly represent the corporation's activities in the State, remedies include requiring separate accounting, inclusion or exclusion of one or more factors, or any other method that results in equitable apportionment and allocation of income. If the request is for both income and franchise tax, a separate determination will be made for each tax.

If the request is denied, the Secretary's decision is final and is not subject to administrative or judicial review. A corporation may not use an alternative apportionment method except upon written order by the Secretary, and any return filed using a method other than the statutory method without the Secretary's permission is not a lawful return.

3. Statutory Procedures for Reporting Net Income or Loss to North Carolina

a. Determine North Carolina Taxable Income

A corporation must determine its State net income or loss from its entire operations conducted everywhere during the income year in accordance with the instructions given in the subject "Computation of Net Income." In computing such net income only contributions to donees outside North Carolina are deductible. Contributions to qualified North Carolina donees are deductible only from total income allocated to North Carolina, computed in Step *h.*

b. Determine Nonapportionable Income

A corporation must review its entire net income or loss as computed in Step *a* to determine whether any items of nonapportionable income, loss and expense qualify for direct allocation to North Carolina and other states pursuant to G.S. § 105-130.4, subdivisions (d) through (h). Any expenses directly and/or indirectly related to an activity that produces nonapportionable income must be considered in the computation of nonapportionable income to be allocated. *See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property"*.

c. Determine Apportionable Income

A corporation determines its apportionable income or loss by deducting all nonapportionable income or loss directly allocable to North Carolina and other states (computed in Step *b*) from its entire net income or loss (computed in Step *a*).

d. Compute Apportionment Factors

A corporation is required to determine and compute the apportionment factor applicable to its principal business operations conducted everywhere during the income year. When the income from specific property constitutes nonapportionable income, the value of such property and items of nonapportionable income, loss, and expense directly allocable to North Carolina and other states must be excluded in computing the apportionment factors.

e. Income Apportioned to North Carolina

A corporation determines the amount of its apportionable income or loss attributable to North Carolina by applying the factor computed in Step *d* to apportionable income or loss as computed in Step *c*.

f. Determine Nonapportionable Income Allocated to North Carolina

A corporation should review the total amount of nonapportionable income or loss as computed in Step *b* and list separately the amount of such income or loss directly allocable to North Carolina. This amount, added to the amount of apportionable income or loss apportioned to this State in Step *e*, represents the total amount of the corporation's entire net income or loss that is subject to North Carolina tax.

g. Percentage Depletion Deduction Before Net Economic or State Net Loss Deduction

The amount of percentage depletion over cost depletion on North Carolina property must be deducted before claiming any net economic or state net loss carryover deduction.

h. Determine Income Before Contributions to North Carolina Donees

To determine total North Carolina income before the deduction for contributions to North Carolina donees, a corporation deducts the allowable portion of any net economic loss or State net loss for a prior year or years from the total income determined as described in Step *g*.

i. Determine Net Taxable Income

Finally, a corporation arrives at its net taxable income in North Carolina by deducting contributions made to qualified North Carolina donees from the amount of total North Carolina income as computed in Step *h*.

H. Taxable in Another State (G.S. § 105-130.4)

1. Preliminary Statement (17 NCAC 05C.0601)

A taxpayer must have income from business activity taxable by this State and at least one other state to allocate and apportion income. Income from business activity includes apportionable or nonappportionable income. Thus, if a taxpayer has nonapportionable income taxable by one state and apportionable income taxable by another state, the taxpayer's income must be allocated and apportioned in accordance with G.S. § 105-130.4. Where a corporation is not taxable in any other state on its apportionable income but is taxable in another state only because of nonapportionable income, all apportionable income is attributed to this State.

2. Definition of Taxpayer (17 NCAC 05C.0602)

The word "taxpayer" includes any corporation subject to the tax imposed by Article 4 of Chapter 105 of the General Statutes.

3. Taxable in Another State

A taxpayer is "taxable in another state" if it meets either one of two tests:

1.If by reason of business activity in another state the taxpayer is "subject to" a net income tax or any other tax measured by net income.

2.If another state has jurisdiction to subject the taxpayer to a net income tax based on business activity regardless of whether or not that state imposes such a tax on the taxpayer.

4. Taxable in Another State – When A Corporation is "Subject To" Tax (17 NCAC 05C.0604)

a. A taxpayer is "subject to" one of the taxes specified above only if it carries on business activities in another state. If the taxpayer voluntarily files and pays such tax when not required by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but

- Does not actually engage in business activities in that state, or
- Does actually engage in some activity not sufficient for nexus and the minimum tax bears no relation to the corporation's activities within such state, the taxpayer is not "subject to" tax within that state and is therefore not "taxable" in another state.

Example: State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return and pays the fifty dollars ($50) minimum tax, although it carries on no activities in State A. Corporation X is not "taxable" in State A.

b. The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activities may impose an income tax even though every state does not do so. In some states, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes which may be considered as basically revenue generating rather than regulatory measures shall be considered in determining whether the taxpayer is "taxable in another state."

Example 1: State A requires all nonresident corporations which qualify or register in State A to pay to the Secretary of State an annual license fee or tax for the privilege of doing business in the state regardless of whether the privilege is in fact exercised. The amount paid is determined according to the total authorized capital stock of the corporation; the rates are progressively higher by bracketed amounts. The statute sets a minimum fee of fifty dollars ($50) and a maximum fee of five hundred dollars ($500). Failure to pay the tax bars a corporation from utilizing the state courts for enforcement of its rights. State A also imposes a corporation income tax. Nonresident Corporation X is qualified in State A and pays the required fee to the Secretary of State but does not carry on any activities in State A other than utilizing its courts. Corporation X is not "taxable" in State A.

Example 2: Same facts as Example 1 except that Corporation X has sufficient business activities in State A to establish nexus under the criteria followed in this state and is, therefore, subject to and pays the corporate income tax. Corporation X is "taxable" in State A.

Example 3: State B requires all nonresident corporations qualified or registered in State B to pay to the Secretary of State an annual permit fee or tax for doing business in the state. The base of the fee or tax is the sum of (1) outstanding capital stock, and (2) surplus and undivided profits. The fee or tax base attributable to State B is determined by a three-factor apportionment formula. Nonresident Corporation X, which operates a plant in State B, pays the required fee or tax to the Secretary of State. Corporation X is "taxable" in State B because of its business activities there.

Example 4: State C has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return based upon its business activities in the state but the amount of computed liability is less than the minimum tax. Corporation X pays the minimum tax. Corporation X is "taxable" in State C.

5. Taxable in Another State – When a State has Jurisdiction to Subject a Taxpayer to a Net Income Tax (17 NCAC 05C.0605)

The second test in Example 3 above applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. §§ 381-385. In the case of any "state", as defined in G.S. § 105-130.4, other than a state of the United States or political subdivision of each state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that "state". If jurisdiction is otherwise present, such "state" is not considered as without jurisdiction by reason of the provisions of a treaty between that state and the United States.

Example: Corporation X is actively engaged in manufacturing farm equipment in State A and in Foreign Country B. Both State A and Foreign Country B impose a net income tax but Foreign Country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and Foreign Country B.

I. Apportionable and Nonapportionable Income (G.S. § 105-130.4)

1. Division of Income – In General (17 NCAC 05C.0701)

When a taxpayer has income from sources within this State as well as income from sources outside this State, the division of income and the resulting determination of the portion of the taxpayer's entire net income that is attributable to this State shall be determined pursuant to the allocation and apportionment provisions set forth in G.S. § 105-130.4. In such cases, the first step is to determine which portion of the taxpayer's entire net income constitutes "apportionable income" and which portion constitutes "nonapportionable income". The various items of nonappportionable income are then directly allocated to specific jurisdictions pursuant to the provisions of subsections (d) through (h) of G.S. § 105-130.4. The apportionable income of the taxpayer other than public utilities, excluded corporations, and qualified capital intensive corporations is divided between the jurisdictions in which the business is conducted pursuant to the property, payroll and sales apportionment factors set forth in subsections (j) though (1) of G.S. § 105-130.4. The sum of (1) the items of nonapportionable income directly allocated to this State, plus (2) the amount of apportionable income attributable to this State by the apportionment formula generally constitutes the amount of the taxpayer's entire net income that is subject to tax under the income tax laws of this State.

The taxpayer shall classify income as apportionable or nonapportionable income on a consistent basis. In the event the taxpayer is not consistent in its reporting, it shall disclose in its return to this State the nature and extent of the inconsistency.

The word "apportionment" generally refers to the division of net income between jurisdictions by the use of a formula containing apportionment factors, and the word "allocation" generally refers to the assignment of net income to a particular jurisdiction.

2. Apportionable and Nonapportionable Income Defined (G.S. § 105.130.4)

"Apportionable income" is defined as all income that is apportionable under the United States Constitution. For purposes of administration of G.S. § 105-130.4, all income of a taxpayer is apportionable income unless clearly classifiable as nonapportionable income under the law and regulations. Nonapportionable income means all income other than apportionable income.

3. Apportionable and Nonapportionable Income – Application of Definitions

The classification of income by the labels customarily given them, such as interest, rents, royalties, and capital gains, is of no aid in determining whether that income is apportionable or nonapportionable income. The gain or loss recognized on the sale of property, for example, may be apportionable income or nonapportionable income depending upon the relation to the taxpayer's trade or business. In general, all income from transactions and activites that are dependent upon or contribute to the operations of a taxpayer is apportionable. Income from unrelated activities is "nonapportionable" income.

4. Proration of Deductions Related to Apportionable and Nonapportionable Income (17 NCAC 05C.0704)

Any allowable deduction that is applicable both to apportionable and nonapportionable income or to more than one "trade or business" of the taxpayer is prorated to those classes of income or trades or businesses in determining income subject to tax. The taxpayer must be consistent in the proration of such deductions in filing returns under these regulations. *See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property"*.

J. Apportionment Factors (G.S. § 105-130.4, G.S. § 105-130.4(i))

1. General Business Corporations

Corporations engaged in multistate business activity, other than public utilities, excluded corporations, and qualified capital intensive corporations are required to apportion to this State all apportionable income by using a four-factor formula. For tax years prior to those beginning on or after January 1, 2016, the apportionment formula consists of the sum of the property factor, the payroll factor and twice the sales factor divided by four. If the sales factor does not exist, the denominator is the number of existing factors. If a property or payroll factor does not exist, the denominator is the number of existing factors plus one. The only time a factor does not exist is when there is no denominator. When there is a denominator for a particular factor, but no numerator, the factor is zero and becomes part of the apportionment factor.

For tax years beginning on or after January 1, 2016, the apportionment factor will be calculated by adding the property factor, the payroll factor, and sales factor times three and dividing the result by five.

For tax years beginning on or after January 1, 2017, the apportionment factor will be calculated by adding the property factor, the payroll factor, and sales factor times four and dividing the result by six.

For tax years beginning on or after January 1, 2018, all income will be apportioned using only the sales factor.

a. Property Factor (G.S. § 105-130.4) (This section is repealed effective for tax years beginning on or after January 1, 2018)

i. Property Factor – In General (17 NCAC 05C.0801)

The property factor includes all real and tangible personal property owned or rented and used during the income year to produce apportionable income. The term "real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment and other real and tangible personal property used in connection with the production of apportionable income but does not include coin or currency. *See definition of "apportionable income"*.

Property used in connection with the production of nonapportionable income that is allocated in accordance with subsections (d) through (h) of G.S. § 105-130.4 is excluded from the factor.

Property used in connection with the production of both apportionable and nonapportionable income is included in the factor only to the extent the property was used in connection with the production of apportionable income. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case.

The property factor includes the average value of property includible in the factor.

ii. Property Factor – Property Used for the Production of Apportionable Income (17 NCAC 05C.0802)

Property is included in the property factor if it is actually used during the income year for the production of apportionable income. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includible in the factor. Property that is permanently idle or idle for the entire taxable year generally is not included in the factor computation. Property or equipment under construction during the income year (except inventoriable goods in process) is excluded from the factor until such property is actually used for the production of apportionable income. If the property is partially used for the production of apportionable income while under construction, the value of the property to the extent used is included in the property factor.

iii. Property Factor – Consistency in Reporting (17 NCAC 05C.0803)

The taxpayer must be consistent in the valuation of property and in excluding or including property in the property factor in filing returns with this State. In the event the taxpayer is not consistent in its reporting, it shall disclose in its return to this State the nature and extent of the inconsistency.

iv. Property Factor – Numerator (17 NCAC 05C.0804)

The numerator of the property factor includes the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the income year for the production of apportionable income.

Property in transit between locations of the taxpayer to which it belongs is considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices is included in the numerator according to the state of destination.

The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which is located within and without this State during the income year is determined for purposes of the numerator of the factor on the basis of total time within the State during the income year. An automobile assigned to a traveling employee is included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

v. Property Factor – Valuation of Owned Property (17 NCAC 05C.0805)

Property owned by the taxpayer is valued at its original cost. "Original cost" of property which has a basis other than zero for federal income tax purposes equals the basis of the property for federal income tax purposes at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, or any other type of disposition.

"Original cost" of property that has a zero basis for federal income tax purposes shall equal the taxpayer's actual cost of the property at the time of acquisition. If the actual cost is unknown, the original cost shall equal the fair market value of the property, or, at the option of the taxpayer, eight times the net annual rental rate as described in G.S. § 105-130.4(j)(2). The valuation method chosen by the taxpayer must be used consistently thereafter.

Example 1: Taxpayer acquired a factory building in this State at a cost of five hundred thousand dollars ($500,000) and years later, expended one hundred thousand dollars ($100,000) for major remodeling of the building. Taxpayer files its return on the calendar year basis and claims a depreciation deduction in the amount of twenty-two thousand dollars ($22,000) on the building. The value of the building includible in the numerator and denominator for the property factor is six hundred thousand dollars ($600,000), as the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

Example 2: X corporation merges into Y corporation in a nontaxable reorganization under the Internal Revenue Code. At the time of the merger, X corporation owns a factory which X built years earlier at a cost of one million dollars ($1,000,000). X has been depreciating the factory at the rate of two percent (2%) per year, and its basis in X's hands at the time of the merger is six hundred thousand dollars ($600,000). Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, the basis in Y's hands is the same as the basis in X's, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e., one million dollars ($1,000,000).

Example 3: Corporation Y acquires the assets of corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under the Internal Revenue Code. Under these circumstances, Y's cost of the assets is the purchase price of the X stock, prorated over the X assets.

Example 4: Corporation X was deeded from local government a potential manufacturing facility (cost unknown) with a market value of one million dollars ($1,000,000) as an incentive for locating in the State. Since the property would have a zero basis for federal income tax purposes under section 118(a), Corporation X includes the one million dollars ($1,000,000) fair market value of the property in the computation of its property factor, or at X's option may include eight times the net annual rental rate of the property.

Inventory of stock of goods is included in the factor in accordance with the valuation method used for federal income tax purposes, except when inventory is valued by use of the LIFO method, actual cost of the FIFO valuation method must be used.

Property acquired by gift or inheritance is included in the factor at its basis for determining depreciation for federal income tax purposes.

vi. Property Factor – Rented Property

Property rented by the taxpayer is valued at eight times the net annual rent paid during the current income year. Net annual rent is the total annual rent paid by the taxpayer less amounts received from subrentals. However, subrentals are not deducted when they constitute apportionable income. Rental values so determined are included in the numerator and denominator and are averaged by including such amounts at the beginning and at the end of the income year.

Example 1: The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. The subrents are apportionable income and are not deducted from rent paid by the taxpayer for the food market.

Example 2: The taxpayer rents a twenty-story office building and uses the lower two stories for its general corporation headquarters. The remaining eighteen (18) floors are subleased to others. The subrents are nonapportionable income and are to be deducted from the rent paid by the taxpayer.

"Annual rent" is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

- Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

  Example: A taxpayer, pursuant to the terms of a lease, pays a lessor one thousand dollars ($1,000) per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of four hundred thousand dollars ($400,000). The annual rent is sixteen thousand dollars ($16,000) (twelve thousand dollars ($12,000) plus one percent (1%) of four hundred thousand dollars ($400,000) or four thousand dollars ($4,000)).

- Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, and does not include amounts paid as service charges, such as utilities, janitorial services, etc. If a payment includes rent and other charges unsegregated, the amount of rent is determined by consideration of the relative values of the rent and the other items.

  Example 1: A taxpayer, pursuant to the terms of a lease, pays the lessor twelve thousand dollars ($12,000) a year rent plus taxes in the amount of two thousand dollars ($2,000) and interest on a mortgage in the amount of one thousand dollars ($1,000). The annual rent is fifteen thousand dollars ($15,000).

  Example 2: A taxpayer stores part of its inventory in a public warehouse. The total charge for the year was one thousand dollars ($1,000) of which seven hundred dollars ($700) was for the use of storage space and three hundred dollars ($300) for inventory, insurance, handling and shipping charges and C.O.D. collections. The annual rent is seven hundred dollars ($700).

"Annual rent" does not include incidental day-to-day expenses such as hotel and motel accommodations, daily rental of automobiles, etc.

Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements is included in the factor.

vii. Property Factor – Averaging Property Values

As a general rule the average value of property owned by the taxpayer is determined by averaging the values at the beginning and ending of the income year. However, the Secretary may require averaging by monthly or other periodic values if such method of averaging is required to properly reflect the average value of the taxpayer's property for the income year.

Averaging by monthly or other periodic values will generally be applied if substantial fluctuations in the values of the property exist during the income year or where property is acquired after the beginning of the income year or disposed of before the end of the income year.

b. Payroll Factor (G.S. § 105-130.4) (This section is repealed effective for tax years beginning on or after January 1, 2018)

i. Payroll Factor – In General

The payroll factor includes the total amount paid by the taxpayer for compensation in connection with earning apportionable income during the income year.

ii. Payroll Accounting Method (17 NCAC 05C.0902)

The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, at the election of the taxpayer, compensation paid to employees may be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under such method for unemployment compensation purposes.

The taxpayer must be consistent in the treatment of compensation paid in filing returns with this State. In the event the taxpayer is not consistent in its reporting it must disclose in its return to this State the nature and extent of the inconsistency.

iii. The Term "Compensation" (17 NCAC 05C.0903)

Compensation means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. **Payments made to an independent contractor or any other person not properly classified as an employee is excluded. Only amounts paid directly to employees are included in the payroll factor.** Amounts considered paid directly include the value of board, rent, housing, lodging and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the Internal Revenue Code. In the case of employees not subject to the Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees is as though such employees were subject to the Internal Revenue Code.

iv. The Term "Employee"

Employee means (1) any officer of a corporation, or (2) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

v. Payroll Factor Includes Only Apportionable Income Compensation and Excludes Compensation Paid to General Executive Officers

The payroll factor includes only compensation that is attributable to income subject to apportionment. The compensation of any employee whose activities are connected primarily with nonapportionable income is excluded from the factor. All compensation paid to general executive officers is excluded in computing the payroll factor. General executive officers include the chairman of the board, president, vice-presidents, secretary, treasurer, comptroller and any other office serving in similar capacities.

Example 1: The taxpayer uses some of its employees in the construction of a storage building that, upon completion, is used for the production of apportionable income. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of such wages is included in the payroll factor.

Example 2: The taxpayer owns various securities from which nonapportionable income is derived. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

vi. Denominator of Payroll Factor (17 NCAC 05C.0906)

Except as provided above, the denominator of the payroll factor is the total compensation paid everywhere during the income year. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is exempt from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

Example: A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In addition the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is exempt from taxation by Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator only of the payroll factor) even though the taxpayer is not taxable in State C.

vii. Numerator of Payroll Factor (17 NCAC 05C.0907)

Except as provided above, the numerator of the payroll factor is the total amount paid in this State during the tax period by the taxpayer for compensation. If compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under such method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this State for unemployment compensation purposes constitutes compensation paid in this State except for compensation excluded under Item *v* above. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this State for unemployment compensation purposes.

Compensation is paid in this State if any one of the following tests, applied consecutively, is met:

1. The employee's service is performed entirely within the State.

2. The employee's service is performed both within and without the State, but the service performed without the State is incidental to the employee's service within the State. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

3. If the employee's services are performed both within and without this State, the employee's compensation will be attributed to this State if:

- The employee's base of operations is in this State; or
- There is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this State; or
- The base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee's residence is in this State.

The words "base of operations" means the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons, or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points.

The words "place from which the service is directed or controlled" refer to the place from which the power to direct or control is exercised by the taxpayer.

viii. Corporations Utilizing Common Paymaster (17 NCAC 05C.0908)

A parent corporation or any corporation serving as common paymaster for payroll purposes shall eliminate from the numerator and denominator of its payroll factor computation the amounts paid on behalf of controlled members for which it has charged such member the exact cost and which does not meet the definition of compensation insofar as the common paymaster is concerned. The numerator and denominator of the payroll factor shall be determined in accordance with applicable statute after elimination of the described amounts.

A subsidiary or otherwise controlled corporation which is a member of and/or participant in a common paymaster plan for payroll purposes, shall include in its numerator and denominator of the payroll factor computation amounts paid to its parent corporation or to another corporation of the controlled group as reimbursement in whatever form and by whatever label for employees' compensation as defined. The amounts paid by the subsidiary or controlled corporation includable in the numerator and the denominator of the payroll factor shall be determined in accordance with applicable statute.

c. Sales Factor (G.S. § 105-130.4)

i. Sales Factor – Sales Made in General Business Operations (17 NCAC 05C.1001)

G.S. § 105-130.4(a)(7) defines "sales" to mean all gross receipts of the taxpayer except receipts from the "casual sale" of property, receipts allocated under subsections (c) through (h) of G.S. § 105-130.4, receipts exempt from taxation, and the portion of receipts realized from the sale or maturity of securities or other obligations that represents a return of principal. For taxable years beginning January 1, 2016, sales also excludes the portion of receipts from financial swaps and other similar financial derivatives representing the notional principal amount that generates cash flow traded in the swap agreement, and dividends subtracted under G.S. § 105-130.5(b)(3a) and (3b), and dividends excluded from federal tax.

Thus, for the purposes of the sales factor, the term "sales" means generally all gross receipts derived by a taxpayer from transactions and activities in the course of its regular trade or business operations which produce apportionable income within the meaning of G.S. § 105-130.4(a)(1).

A "casual sale" of property means the sale of any property that was not purchased, produced, or acquired primarily for sale in the corporation's regular trade or business.

In the case of a taxpayer whose business activity consists of manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts means gross sales, less returns and allowances, and includes all interest income, service charges, carrying charges or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if such taxes are passed on to the buyer or included as part of the selling price of the product.

ii. Sales Factor – Sales Incidental To General Business Operations (17 NCAC 05C.1002)

As a general rule, "sales" also includes gross receipts derived by a taxpayer from business transactions or activities which are incidental to its principal business activity and which are includable in apportionable income. However, substantial amounts of gross receipts arising from an incidental or occasional sale of a fixed asset used in connection with the taxpayer's regular trade or business will be excluded from the sales factor since such sales constitute a "casual sale" of property and the inclusion of such gross receipts will not fairly apportion to this State the income derived by the taxpayer from its business activity in this State. For example, gross receipts from the sale of a factory or plant will be excluded from the sales factor but the gain or loss on the sale will be included in apportionable income.

Likewise, the "proceeds" from "rollover" of working capital invested in certificates of deposits, money market accounts, etc., on a short-term temporary basis are not considered gross receipts for sales factor purposes. The earnings of such investments whether labeled as gains or interest will be the only amounts includable in the sales factor.

In including or excluding gross receipts, the taxpayer shall be consistent in the treatment of such gross receipts in filing returns with this State. In the event the taxpayer is not consistent in its reporting, it shall disclose in its return to this State the nature and extent of the inconsistency.

iii. Sales Factor – Sales Made In Other Types of Business Activity (17 NCAC 05C.1003)

As applied to a taxpayer engaged in business activity other than the manufacturing and selling or purchasing and reselling of property, "sales" includes the gross receipts as defined in this subject.

If the business activity consists of providing services, such as the operation of an advertising agency, or the performance of equipment service contracts, research and development contracts, "sales" includes the gross receipts from the performance of such services including fees, commissions, and similar items including prepaid amounts for these services.

In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, gross receipts includes the entire reimbursed cost, plus the fee.

If the business activity is the renting of real or tangible personal property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.

If the business activity is the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

iv. Sales Factor – Numerator (17 NCAC 05C.1004)

The numerator of the sales factor will include the gross receipts from sales which are attributable to this State, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales regardless of the place where the accounting records are maintained or the location of the contract or other evidence of indebtedness.

Where a taxpayer is not taxable in another state on its apportionable income but is taxable in another state only because of nonapportionable income, all sales shall be attributable to this State.

v. Sales Factor – What Sales of Tangible Personal Property Are In This State (17 NCAC 05C.1005)

Gross receipts from the sales of tangible personal property are in this State if the property is delivered or shipped to a purchaser within this State regardless of the f.o.b. point or other conditions of sale.

Property shall be deemed to be delivered or shipped to a purchaser within this State if the recipient is located in this State, even though the property is ordered from outside this State.

Example: The taxpayer, with inventory in State A, sold one hundred thousand dollars ($100,000) of its products to a purchaser having branch stores in several states including this State. The order for the purchase was placed by the purchaser's central purchasing department located in State B. Twenty-five thousand dollars ($25,000) of the purchase order was shipped directly to purchaser's branch store in this State. The branch store in this State is the "purchaser within this State" with respect to twenty-five thousand dollars ($25,000) of the taxpayer's sales.

Property is delivered or shipped to a purchaser within this State if the shipment terminates in this State, even though the property is subsequently transferred by the purchaser to another state.

Example: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this State at which all merchandise purchased is received. The purchaser reships all the goods to its branch stores in other states for sale.

All of the taxpayer's products shipped to the purchaser's warehouse in this State are property "delivered or shipped to a purchaser within this State."

The term “purchaser within this State” shall include the ultimate recipient of the property if the taxpayer in this State, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this State.

Example: A taxpayer in this State sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser’s customer in this State pursuant to the purchaser’s instructions. The sale by the taxpayer is “in this State.”

When property being shipped by a seller from the state of origin to a consignee in another state is diverted while in route to a purchaser in this State, the sales are in this State.

Example: The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser’s place of business in State B. While in route the produce is diverted to the purchaser’s place of business in this State where the taxpayer is subject to tax. The sale by the taxpayer is attributed to this State.

vi. Sales Factor – Sales To United States Government (17 NCAC 05C.1006)

Gross receipts from the sales of tangible personal property to the United States Government are in this State if the property is shipped to or received or accepted by the United States Government in this State. For the purposes of this regulation, only sales for which the United States Government makes direct payment to the seller pursuant to the terms of its contract constitute sales to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government.

Example 1: A taxpayer contracts with General Services Administration to deliver X number of trucks which were paid for by the United States Government. The United States Government is the purchaser.

Example 2: The taxpayer is a subcontractor to a prime contractor with the National Aeronautics and Space Administration and contracts to build a component of a rocket for one million dollars ($1,000,000). The sale of the subcontractor to the prime contractor is not a sale to the United States Government.

When the United States Government is the purchaser of property which remains in the possession of the taxpayer in this State for further processing under another contract, or for other reasons, “shipment” is deemed to be made at the time of acceptance by the United States Government.

vii. Sales Factor – Numerator – Other Receipts Constituting Apportionable Income

G.S. § 105-130.4(l)(3) contains provisions for including gross receipts from other business income transactions in the numerator of the sales factor. Under this subsection gross receipts are attributed to this State, if:

1. The receipts are from real or tangible property located in this State; or
2. The receipts are from intangible property and are received from sources in this State; or
3. The receipts are from services and the income producing activity that gave rise to the receipts is performed within this State.

The term "income producing activity" means the act or acts directly engaged in by the taxpayer, or by anyone acting on the taxpayer's behalf, in the regular course of its trade or business for the ultimate purpose of obtaining gains or profits.

Except for receipts from the casual sale of property, as defined above, receipts described above from other transactions constituting apportionable income shall be attributed to this State as set forth below:

1. Gross receipts from the sale, lease, rental or other use of real property are in this State if the real property is located in this State.

2. Gross receipts from the sale of electricity if the location of the income producing activity is located in this State.

3. Gross receipts from the rental, lease, licensing the use of, or other use of tangible property shall be assigned to this State if the property is within this State during the entire period of rental, lease, license or other use. If the property is within and without this State during such period, gross receipts attributable to this State shall be based upon the ratio which the time the property was physically present or was used in this State bears to the total time or use of the property everywhere during such period.

4. Gross receipts from intangible personal property shall be attributed to this State if they are received from sources within this State.

Example 1: Royalties from trademarks are attributed to this State to the extent the royalties are used in this State.

Example 2: Royalties from patents, secret processes, or other similar intangible property are attributed to this State to the extent the patent, secret process, or other similar intangible property is employed in production, fabrication, manufacturing, processing, or other similar use in this State.

Example 3: Royalties from copyrights are attributable to this State to the extent that printing or other publication originates in this State.

Example 4: Dividends are attributable to this State if the payer's commercial domicile is in this State.

Example 5: Interest received from general obligations is attributable to this State if the payer's commercial domicile is in this State.

Example 6: Interest received from specific obligations is attributable to this State if the obligation can be traced to property in this State. For example, interest received from a loan obtained and used by the borrower to buy a piece of real estate in North Carolina is attributable to this State. Interest received from a loan in which real or tangible personal property located in this State is used for collateral is attributable to this State. Interest received as the result of nonpayment or deferred payment of royalties on trademarks is attributable to this State in the same proportion as the royalties are attributable to North Carolina.

5. Gross receipts for the performance of personal services are attributable to this State to the extent such services are performed in this State. If the services are performed partly within and without this State, such receipts shall be attributed to this State based upon the ratio which the time spent in performing such services in this State bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts.

Example 1: The taxpayer, a road show, gave theatrical performances at various locations in State X and in this State during the income year. All gross receipts from performances given in this State are attributed to this State.

Example 2: The taxpayer, a public opinion survey corporation, conducted a poll by its employees in State X and in this State for the sum of nine thousand dollars ($9,000). The project required six hundred 600 man-hours to obtain the basic data and prepare the survey report. Two hundred (200) of the six hundred (600) man-hours were expended in this State. The receipts attributable to this State are three thousand dollars ($3,000).

$$\frac{\text{200 man-hours}}{\text{600 man-hours}} \times \$9{,}000 = \$3{,}000$$

6. Gross receipts for prepaid services are attributable to this State if the sale of such services are sold in conjunction with or related to tangible property sold or used in this State.

2. Public Utilities, Excluded Corporations, and Qualified Capital Intensive Corporations Apportionment Factors (G.S. § 105-130.4)

a. Preliminary Statement

Special apportionment provisions apply to certain types of corporations and excluded corporations. G.S. § 105-130.4 should be consulted for definitions and specific apportionment and allocation requirements. The Department refers to the North American

Industry Classification System (NAICS) as a means of determining whether a taxpayer's business operations require the corporation to use the special apportionment provisions.

b. Railroad Companies

All apportionable income of a railroad company must be apportioned to North Carolina by multiplying the income by a fraction, the numerator of which is the railway operating revenue from business done within North Carolina and the denominator of which is the total railway operating revenue everywhere.

c. Telephone Companies

All apportionable income of a telephone company must be apportioned to this State by multiplying the income by a fraction. The numerator of the fraction is gross operating revenue from local service in North Carolina plus gross operating revenue from toll services performed wholly within North Carolina plus the proportion of revenue from interstate toll services attributable to North Carolina as shown by the records of the company plus the gross operating revenue in North Carolina from other services less the uncollectible revenue in North Carolina. The denominator of the fraction is the total gross operating revenue everywhere less total uncollectible revenue.

d. Motor Carriers of Property and/or Passengers

All apportionable income of a motor carrier of property and/or passengers must be apportioned by multiplying the income by a fraction, the numerator of which is the number of vehicle miles in North Carolina and the denominator of which is the total number of vehicle miles of the company everywhere. The word "vehicle miles" shall mean miles traveled by vehicles owned or operated by the company hauling property or passengers for a charge or traveling on a scheduled route.

e. Telegraph Companies

All apportionable income of a telegraph company must be apportioned by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

f. Excluded Corporations, including Construction Contractors, and Other Public Utilities

All apportionable income of an excluded corporation and all other public utilities must be apportioned by multiplying apportionable income by the sales factor as defined in G.S. § 105-130.4. "Excluded corporation" means any company engaged in business as a building or construction contractor, a securities dealer, loan company or company which receives more than fifty percent (50%) of its ordinary gross income from intangible property.

This section is repealed for tax years beginning on or after January 1, 2018 because it is no longer necessary.

g. Air or Water Transportation Corporations

All apportionable income of an air or water transportation corporation must be apportioned by a fraction, the numerator of which is the corporation’s revenue ton-miles in this state and the denominator of which is the corporation’s revenue ton-miles everywhere. A qualified air freight forwarder shall use the revenue ton mile fraction of its affiliated air carrier.

The following definitions apply:

Air carrier. – A corporation engaged in the business of transporting any combination of passengers or property of any kind in interstate commerce, and the majority of the corporation's revenue ton miles everywhere are attributed to transportation by aircraft.

Air transportation corporation. – One or more of the following:
a. An air carrier that carries any combination of passengers or property of any kind.
b. A qualified air freight forwarder.

Qualified air freight forwarder. – A corporation that is an affiliate of an air carrier and whose air freight forwarding business is primarily carried on with the affiliated air carrier.

Revenue ton-mile. - One ton of passengers, freight, rail, or other cargo carried one mile by aircraft, motor vehicle, or vessel. In making this computation, a passenger is considered to weigh two hundred pounds.

h. Qualified Capital Intensive Corporations

All apportionable income of a qualified capital intensive corporation must be apportioned by using the sales factor only. To qualify, a corporation must construct a facility with at least $1 billion of private fund investment and that is completed within nine (9) years after construction begins. In addition, the corporation must meet all of the following conditions:

i. The Secretary of Commerce makes a written determination of the required investment amount and timing.
ii. The average number of employees at the facility in the first 2 years after placed in service remains the same or is increased during the remainder of the required investment period.
iii. The facility was located in a tier 1 or 2 area (as determined by the Department of Commerce) when construction began.
iv. The wage standard at the facility meets the requirements of G.S. § 105-164.3(33c)a.
v. The full-time employees of the facility are provided health insurance meeting the requirements of G.S. § 105-164.3(33c)c.

If a corporation meets the above criteria, and the corporation's property factor exceeds 75% of the total apportionment factor (including double weighted sales factor), or the corporation average property factor for the prior three years meets the 75% threshold, then the corporation qualifies for the special apportionment.
This section is repealed for tax years beginning on or after January 1, 2018 because it is no longer needed.

K. Deduction of Contributions (G.S. § 105-130.9)

1. Preliminary Statement

Subject to certain limitations, contributions or gifts made by a corporation within the income year to qualified donees are deductible in determining net income.

2. Charitable Contribution Defined

For purposes of this section charitable contributions are defined in section 170(c) of the Internal Revenue Code.

3. Contributions Limited to Five Percent (5%) of Net Income

The deduction for contributions made to qualified organizations, other than those discussed in section 4 below, are limited to five percent (5%) of the corporation's net income as determined before the deductions for contributions. Excess contributions cannot be carried over for use in subsequent years.

4. Contributions Fully Deductible

Contributions or gifts made by a corporation to the State of North Carolina, a county in North Carolina, a municipality in North Carolina, or any of their institutions, instrumentalities, or agencies, and to qualified educational institutions located within North Carolina are fully deductible in arriving at net income or loss. "Educational institution" means only an educational institution that normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where the educational activities are carried on. This term includes the institution's departments, schools and colleges as well as a group of educational institutions and an organization (corporation, trust, foundation, association or other entity) organized and operated exclusively to receive, hold, invest and administer property and to make expenditures to or for the sole benefit of an educational institution or group of such institutions.

Example: Corporation B deducted contributions of one hundred dollars ($100) to a North Carolina county agency, fifty dollars ($50) to a college located in North Carolina and fifty dollars ($50) to other qualified donees in determining net income of one thousand dollars ($1,000) before deduction of a net economic loss (or State net loss) of five hundred dollars ($500). The allowable contributions deduction is computed as follows:

Net income	$1,000	
Add: Contributions	200	
Net income before net economic loss deductions	$1,200	
Less: Net Economic Loss (or State net loss) brought forward		500
Net income before contributions deduction		$ 700

Less allowable contributions:		
Other qualified donees (not to exceed 5% of $700)	35	
College located in North Carolina	50	
North Carolina county agency	100	
		$ 185
Net taxable income		$ 515

5. Contributions by Corporations Allocating Net Income

A corporation which is required to apportion its total net income to North Carolina by using the allocation and apportionment methods in G.S. § 105-130.4 must deduct from total net income allocable to North Carolina the contributions it made to North Carolina donees qualified in subdivisions (1) and (2) of G.S. § 105-130.9.

However, the deduction for contributions made to North Carolina donees qualified in subdivision (1) of G.S. § 105-130.9 is limited to five percent (5%) of total net income allocated to North Carolina as computed before this deduction. Furthermore, the contributions that qualify as a direct deduction from total net income allocated to North Carolina cannot be deducted in arriving at the corporation's total net income subject to apportionment.

Example: Corporation C's records show net income of one hundred fourteen thousand dollars ($114,000) before the deductions for a net economic loss (or State net loss) and contributions. Contributions total six thousand two hundred dollars ($6,200) and include two hundred dollars ($200) to a North Carolina agency, two thousand dollars ($2,000) to other North Carolina donees and (four thousand dollars ($4,000) to qualified donees located outside North Carolina.

The deduction for contributions is determined as follows:

Net income before contributions and net economic loss deduction	114,000
Less: Contributions to donees outside North Carolina	4,000
Total	$110,000
Less: Total nonapportionable income	10,000
Total apportionable income	$100,000
Apportionable to North Carolina —35%	$ 35,000

Add: Nonapportionable income directly allocated to North Carolina	1,000		
Total income allocated to North Carolina			$ 36,000
Less: Allowable portion of net economic loss (or State net loss) deduction			6,000
Total income allocated to NC before contributions to donees			$ 30,000
Less: Contributions			
North Carolina donees (not to exceed 5% of $30,000)		$1,500	
North Carolina county agency		200	
		$ 1,700	
Net taxable income			$ 28,300

L. Rapid Amortization of Equipment Mandated by OSHA (G.S. § 105-130.10A)

A corporation may, at its option and in lieu of any regular depreciation allowance, recover over a period of sixty (60) months its cost of any equipment mandated by the Occupational Safety and Health Act (OSHA). “Cost” shall include the cost of planning, acquiring, constructing, modifying, and installing such equipment.

“Equipment mandated by OSHA” refers to any tangible personal property and other buildings and structural components of buildings in which the corporation must acquire, contract, install, or make available in order to comply with the occupational safety and health standards adopted and promulgated by the United States Secretary of Labor or the Commissioner of Labor of North Carolina.

M. Amortization of Bond Premiums (G.S. § 105-130.5)

1. Preliminary Statement (17 NCAC 05C.1401)

If a corporation purchases a bond at more than its face value, the amount of premium paid may be amortized over the life of the bond. However, the allowance of a deduction against net income for amortization of the premium paid depends upon the type of bond purchased by the corporation.

Amortization of premiums on *tax-exempt* bonds by a corporation is mandatory with no deduction allowed in computing State net income.

A corporation may at its option amortize the amount of premiums paid on taxable bonds over the life of the bonds. If the premium is not amortized by the corporation, it will constitute part of the basis of the bond in determining gain or loss at maturity or sale.

For State income tax purposes, obligations of the United States or its possessions and obligations of the State of North Carolina or any of its subdivisions are tax-exempt. Interest income received by a corporation on such obligations is not taxable; however, a corporation must include in its computation of State net income any gain or loss realized on the disposal of such obligations.

Premiums paid on all bonds acquired prior to January 1, 1963 cannot be amortized but constitute a part of the cost basis of the bonds in determining gain or loss when the bonds are sold.

2. Tax-Exempt Bonds (17 NCAC 05C.1402)

The amount of premium paid upon the purchase of a tax-exempt bond is amortized over the life of the bond. Amortization for the taxable year is accomplished by reducing the original cost of the bond by a portion of the premium paid, with no deduction against net income for the year. Therefore, when the bond is sold or otherwise disposed of, the basis for determining gain or loss will always be original cost less the amount of premium amortized for book purposes through the year of disposal.

Example: A corporation pays five thousand one hundred dollars ($5,100) for a five-year tax-exempt interest-bearing bond having a par value of five thousand dollars ($5,000). The premium of one hundred dollars ($100) paid upon the purchase of the bond must be amortized over the life of the bond and cannot be used as a deduction in determining net income. The bond is sold after two years for five thousand one hundred dollars ($5,100). Although interest earned on the bond is not taxable, the corporation is required to report the sale as follows:

Sales price		$5,100
Basis of bond sold:		
Cost	$5,100	
Less: Premium amortized	40	
		$5,060
Gain		$ 40

3. Taxable Bonds (17 NCAC 05C.1403)

A portion of the premium paid upon the purchase of a taxable bond may be deducted in the taxable year only if an adjustment is made to the basis of the bond. If a taxpayer elects to amortize the premium, the basis for determining gain or loss will always be original cost less the amount of premium amortized and deducted in its tax returns through the year of disposal. Otherwise, the basis of a taxable bond for determining gain or loss will always be the entire amount paid for the bond.

Example 1: A corporation pays twelve thousand five hundred dollars ($12,500) for a taxable interest-bearing bond having a par value of twelve thousand dollars ($12,000). The bond matures in ten years. Since the interest from the bond represents taxable income to the corporation, it elects to amortize the premium paid over the life of the bond. One-tenth of the premium, or fifty dollars ($50), is allowable as an annual deduction in determining net income.

At the end of five years the corporation sells the bond for twelve thousand three hundred seventy-five dollars ($12,375). The corporation is required to report the sale as follows:

Sales price		$12,375
Basis of bond sold:		
Cost	$12,500	
Less: Premium amortized	250	
		$12,250
Gain		$ 125

Example 2: In the previous example, if the corporation had elected not to amortize the premium, it would be required to report the sale of bond as follows:

Sales price	$12,375
Basis of bond sold:	
Cost	$12,500
Loss	($ 125)

4. Definition of Bond (17 NCAC 05C.1404)

The term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation and bearing interest and includes any like obligation issued by any government or political subdivision thereof.

N. Net Economic Loss Carry-Over (G.S. § 105-130.8)

1. Preliminary Statement

For tax years beginning *before* January 1, 2015 and after January 1, 1993, North Carolina allows a carry forward of a net economic loss for a period of fifteen (15) years. A net economic loss carried forward from any year is first applied to, or offset by, any income taxable or nontaxable of the next succeeding year before any portion of the loss may be carried forward to a succeeding year.

For tax years beginning on or after January 1, 2015, see **Section N. State Net Loss**.

2. Differences Between North Carolina and Federal Provisions

The loss deduction allowed for North Carolina income tax purposes differs from the loss deduction permitted for Federal income tax purposes in two principal ways:

a. For North Carolina tax purposes, the loss must be a net *economic* loss rather than a net *operating* loss.

b. For North Carolina tax purposes, a loss can *only be carried forward*, whereas under the Federal law a loss may also be carried back to years preceding the loss year.

3. Net Economic Loss

a. Net Economic Loss Definition

A net economic loss for any year means the amount by which allowable deductions, other than prior years' losses, exceeds income from all sources in the year including any income not taxable under Article 4, Part 1 of the North Carolina Revenue Act. *Dayco Corporation v. Clayton*, Commissioner of Revenue (1967), 269 N.C. 490,153 S.E. 2nd 28.

b. Procedure for Deducting a Net Economic Loss

A net economic loss from a prior year may be carried forward from the loss year and deducted from income in the next succeeding year. However, any such loss carried forward must be reduced or offset by any *income not taxable* received in the succeeding year in determining the amount of net economic loss deduction in such succeeding year. Any unused portion of a net economic loss remaining may be carried forward to the next succeeding year. (See *Dayco Corporation v. Clayton*.)

c. Substantiation

Taxpayers must maintain and make available for inspection all records necessary to determine and verify the amount of State net loss deduction. In addition, the Department or the taxpayer may redetermine a loss in a year that is closed under the statute of limitations to adjust the amount that may be carried forward in an open tax year.

4. Income Not Taxable

Income not taxable includes any income item that has been deducted in computing State net income under G.S. § 105-130.5, any nonapportionable income that has been allocated directly to another state under G.S. § 105-130.4, and any other income that is not taxable under State law. (See *Dayco Corporation v. Clayton*.) The amount of the income item considered income not taxable for corporate income tax is determined after subtracting related expenses for which a deduction was allowed for corporate income tax.

5. Corporations Allocating and Apportioning Their Net Income (17 NCAC 05C.1506)

A corporation required to allocate and apportion its net income or net loss under G.S. § 105-130.4 may carry forward only a portion of its net economic loss. After the required adjustments for income not taxable in the next succeeding year have been made, the apportioned part of such determined net economic loss deduction is deducted from the total amount of income allocated and apportioned to this State. For example, a corporation apportioning fifty percent (50%) of its net income or loss to North Carolina in a particular year in which it sustains a total net economic loss of one thousand dollars ($1,000) may carry forward only five hundred dollars ($500) to a subsequent year.

Where the apportioning corporation earns nonapportionable income subject to direct allocation outside North Carolina in a year succeeding the loss-year, the portion of the directly allocated income used to offset the loss brought forward is determined by applying to such income the apportionment percentage applicable to the succeeding year.

6. Corporation Sustaining Loss Entitled to Deduction (17 NCAC 05C.1507)

In the case of a merger of a loss corporation and a profit corporation, pre-merger losses may be offset against post-merger profits if the following three tests are met:

1. The "but-for" test, which allows the deduction if, but for the merger, the corporation suffering the loss would have been able to utilize the deduction;

2. The "assets" test, which allows the deduction only to the extent that the group of assets that was previously operated at a loss is operated at a profit after the merger. Accounting records must show clearly the income and expenses attributable to such groups of assets; and

3. The "substantially the same business" test, which allows the deduction if the business of the acquired corporation which sustained the loss has not been materially altered or enlarged by the merger.

See *Good Will Distributors (Northern) Inc. v. Currie*, Commissioner of Revenue, 251 N.C. 120, 110 S.E.2d 880 (1959); *Holly Farms Poultry Industries, Inc. v. Clayton*, Commissioner of Revenue, 9 N.C. App. 345, 176 S.E.2d 367 (1970); *Fieldcrest Mills, Inc. v. Coble*, 290 N.C. 504, 135 S.E.2d 205 (1976); *Bellsouth Telecommunications, Inc., d/b/a Southern Bell Telephone and Telegraph Company v. Department of Revenue*, 485 S.E.2d 333 (1997).

7. Example

The following example shows the proper method of computing net economic losses and the correct procedure for carrying them forward as deductions. For the federal and NC returns used in this example, see:

http://www.dornc.com/taxes/corporate/impnotice_8-12.pdf.

ABC Loss Co ("ABC") is a North Carolina corporation engaged in the business of manufacturing chemicals within and without this State. ABC's business is not directed or managed from its North Carolina offices; ABC's commercial domicile is not in this State. For 2013, ABC filed a federal form 1120, showing a taxable loss of $199,000.

In determining the federal taxable loss for years 2013, the corporation includes the following income and deduction items:

a. Dividend income from more than 20% owned corporations in the amount of $3,050,000.

b. Dividend income from affiliated group members in the amount of $1,808,000.

c. Dividend income from foreign corporations in the amount of $1,043,000.

d. U.S. Government interest income in the amount of $26,000.

e. Other income in the amount of $10,000,000.

f. Other deductions in the amount of $11,878,000.

g. A special deduction in the amount of $4,248,000.

In determining State net income, the corporation makes the following adjustments to its federal taxable loss:

a. Deducts U.S. Government interest in the amount of $26,000.

b. Deducts dividend income from foreign corporations in the amount of $1,043,000.

In addition, the corporation classifies dividend income in the amount of $610,000 as nonapportionable income. The amount of nonapportionable dividend income is calculated by reducing the amount of dividend income reported in 2010 ($5,901,000) by the sum of the special deduction ($4,248,000) and the dividend income from foreign corporations ($1,043,000).

During tax year 2013, the corporation received life insurance proceeds in the amount of $50,000 as a result of the death of an employee and the proceeds were excluded from federal taxable income.

For tax year 2013, the North Carolina apportionment factor is sixty percent (60%).

Computation of Corporate Income Tax for 2013

Federal Taxable Income		(199,000)	
Adjustments to Federal Taxable Income			
Deduct: U.S. Government Interest	26,000		
Deduct: Foreign Dividends	1,043,000		1,069,000
N.C. Taxable Income			(1,268,000)

Nonapportionable Income			
Deduct: Dividend Income Classified as Nonapportionable			610,000
Apportionable Income			(1,878,000)
Apportionment Factor			60.0000%
Income Apportionable to N.C.			(1,126,800)
Nonapportionable Income Allocated Directly to NC			0
Income Subject to N.C. Tax for 2013			(1,126,800)

Computation of Net Economic Loss for 2013

Apportionable Income			(1,878,000)
Income sources received in 2013 not taxable in North Carolina:			
Add: Life insurance proceeds	50,000		
Add: Nonapportionable dividend income		610,000	660,000
Net economic loss for tax year 2013			(1,218.800)
Apportionment Factor			60.0000%
Net economic loss apportioned to N.C. for tax year 2013			**(730,800)**

For 2014, the corporation's federal taxable loss is $772,500.

In determining the federal taxable loss for tax year 2014, the corporation includes the following income and deduction items:

a. Dividend income from more than 20% owned corporations in the amount of $4,050,000.

b. Dividend income from affiliated group members in the amount of $1,808,000.

c. U.S. Government interest income in the amount of $6,000.

d. Other income in the amount of $5,000,000.

e. Other deductions in the amount of $6,588,500.

f. A special deduction in the amount of $5,048,000.

In determining State net income, the corporation deducts U.S. Government interests in the amount of $6,000. The corporation also classifies dividend income in the amount of $810,000 as nonapportionable income. The amount of nonapportionable dividend income ($810,000) is calculated by reducing the amount of dividend income reported in 2011 ($5,858,000) by the amount of special deduction ($5,048,000).

For tax year 2014, the North Carolina apportionment factor is seventy percent (70%).

In addition in tax year 2014, the corporation received interest income from municipal bonds in the amount of $100,000 that was not taxed for federal or State income tax purposes.

Computation of Corporate Income Tax for 2014

Federal Taxable Income	(772,500)	
Adjustments to Federal Taxable Income		
Deduct: U.S. Government Interest		6,000
N.C. Taxable Income		(778,500)
Nonapportionable Income		
Deduct: Dividend Income Classified as Nonapportionable		810,000
Apportionable Income		(1,588,500)
Apportionment Factor		70.0000%
Income Apportionable to N.C.		(1,111,950)
Nonapportionable Income Allocated Directly to NC		0
Income Subject to N.C. Tax for 2014		(1,111,950)

Computation of Net Economic Loss for 2014

Apportionable Income			(1,588,500)
Income sources received in 2014 not taxable in North Carolina:			
Add: Nonapportionable dividend income		810,000	
Add: Municipal bond interest income	100,000		910,000
Net economic loss for tax year 2014			(678.500)
Apportionment Factor			70.0000%

Net economic loss apportioned to N.C. for tax year 2014 **(474,950)**

Computation of Net Economic Deduction

Net economic loss apportioned to North Carolina for tax year 2013			(730,800)
Income received in 2014 not taxable in North Carolina:			
Dividend received deduction (70% of 5,048,000)		3,533,600	
U.S. Government interest (70% of 6,000)		4,200	
Nonapportionable dividend income (70% of 810,000)	567,000		
Municipal bond interest income (70% of 100,000)	70,000	4,174,800	
Net economic loss deduction			**0****

**(No net economic loss deduction exists from net economic loss created in 2013 because the net economic loss apportioned to North Carolina for tax year 2013 does not exceed the amount of income not taxable in North Carolina received in 2014. Therefore, the only net economic loss available to be carried forward to tax year 2015 is the net economic loss created in 2014, which is 474,950.)

O. State Net Loss Deduction (G.S. § 105-130.8A)

1. Preliminary Statement

For tax years beginning *on or after* January 1, 2015, corporate taxpayers will no longer use a net economic loss calculation under G.S. § 105-130.8, but rather will use a State net loss calculation that is more comparable to the federal net operating loss deduction.

2. State Net Loss

a. A State net loss for a taxable year means the amount by which allowable deductions (not including any prior year losses) exceed gross income under the Code as adjusted under G.S. § 105-130.5. For taxpayers that have income from business activities within and without North Carolina, the loss must be allocated and apportioned pursuant to G.S. § 105-130.4.

b. A taxpayer may carry forward a State net loss from a prior tax year and deduct the amount in the current tax year, subject to the following limitations:

i. The loss must have been created in one of the preceding fifteen (15) tax years;

ii. Any loss carried forward must be applied first to the immediately succeeding tax year before any portion may be carried forward to a subsequent tax year; and

iii. In the case of a merger or acquisition, the standards contained in Treasury Regulations under sections 381 and 382 of the Code are applied to determine the amount of losses that survive for North Carolina purposes.

c. Taxpayers must maintain and make available for inspection all records necessary to determine and verify the amount of State net loss deduction. In addition, the Department or the taxpayer may redetermine a loss in a year that is closed under the statute of limitations to adjust the amount that may be carried forward in an open tax year.

3. Corporations Allocating and Apportioning Their Net Income

A corporation required to allocate and apportion its net income or net loss under G.S. § 105-130.4 may carry forward only a portion of its State net loss. The apportioned part of State net loss deduction is deducted from the total amount of income allocated and apportioned to this State. For example, a corporation apportioning fifty percent (50%) of its net income or loss to North Carolina in a particular year in which it sustains a total State net loss of one thousand dollars ($1,000) may carry forward only five hundred dollars ($500) to a subsequent year.

Where the apportioning corporation earns nonapportionable income subject to direct allocation outside North Carolina in a year succeeding the loss-year, the portion of the directly allocated income used to offset the loss brought forward is determined by applying to such income the apportionment percentage applicable to the succeeding year.

4. Coordination with Net Economic Loss Provisions

Beginning January 1, 2015, unused net economic losses become a static amount. In addition, as of January 1, 2015, any unused portion of a net economic loss carried forward will not have to be offset by nontaxable income.

5. Example

The following example shows the proper method of computing a State net loss and the application of G.S. § 105-130.8A.

The facts are the same as the Example in Item 7, except ABC's income item amounts and losses occur in tax years 2014 and 2015, respectively, as follows:

Computation of Corporate Income Tax for 2014

Federal Taxable Income		(199,000)	
Adjustments to Federal Taxable Income			
Deduct: U.S. Government Interest	26,000		
Deduct: Foreign Dividends	1,043,000		1,069,000
N.C. Taxable Income			(1,268,000)
Nonapportionable Income			
Deduct: Dividend Income Classified as Nonapportionable			610,000

Apportionable Income	(1,878,000)
Apportionment Factor	60.0000%
Income Apportionable to N.C.	(1,126,800)
Nonapportionable Income Allocated Directly to NC	0
Income Subject to N.C. Tax for 2014	(1,126,800)

Computation of Net Economic Loss for 2014

Apportionable Income		(1,878,000)
Income sources received in 2014 not taxable in North Carolina:		
Add: Life insurance proceeds	50,000	
Add: Nonapportionable dividend income	610,000	660,000
Net economic loss for tax year 2014		(1,218.800)
Apportionment Factor		60.0000%
Net economic loss apportioned to N.C. for tax year 2014		**(730,800)**

Computation of Corporate Income Tax for 2015

Federal Taxable Income	(772,500)
Adjustments to Federal Taxable Income	
Deduct: U.S. Government Interest	6,000
N.C. Taxable Income	(778,500)
Nonapportionable Income	
Deduct: Dividend Income Classified as Nonapportionable	810,000
Apportionable Income	(1,588,500)
Apportionment Factor	70.0000%
Income Apportionable to N.C.	(1,111,950)
Nonapportionable Income Allocated Directly to NC	0

Income Subject to N.C. Tax	(1,111,950)		
State net loss for tax year 2015			**(1,111,950)**
****Net economic loss deduction from 2014**		**(730,800)**	
State net taxable income and state net loss carryover		**(1,842,750)**	

**Beginning on or after January 1, 2015, a net economic loss carried forward from a prior year becomes a static amount, and as of January 1, 2015, will not have to be first offset by nontaxable income in that year or any future years.

P. Secretary's Authority to Adjust Net Income or Require a Combined Return (G.S. 105-130.5A)

1. Preliminary Statement (17 NCAC 05F.0101)

When the Secretary has reason to believe that any corporation conducts its business in such a manner as to fail to accurately report its State net income properly attributable to its business carried on in this State through the use of intercompany transactions that are not at fair market value or lack economic substance, the Secretary may request in writing that the corporation provide any information reasonably necessary to substantiate the economic substance and appropriate fair market value of the corporation's intercompany transactions. A corporation must provide the requested information within ninety (90) days of the request.

2. Definitions (G.S. § 105-130.5A(j) and 17 NCAC 05F.0102)

As used in G.S. § 105-130.5A, the following definitions apply:

a. Affiliated group is two or more corporations or noncorporate entities in which more than fifty percent (50%) of the voting stock or membership interest is controlled by a common owner or owners.

b. Centralized cash management means a process that an affiliated group of businesses makes most or call cash management decisions from one location (e.g., headquarters or designated subsidiary) with individual subsidiaries have little authority over cash management decisions.

c. Economic position means the status of a taxpayer's assets, liabilities, and equity (whether actual, contingent, or potential) and the interrelationships to one another.

d. Material benefit means an improvement in the economic position of the taxpayer on a pre-tax basis.

e. Material business activity means an activity that is an integral part of the unitary group's business **and** performed on a regular and continual basis.

f. Principal member means a member of the combined group that acts in the group's name for all income tax liability matters of the combined group and is responsible for preparing and making income tax payments for the combined group.

g. Unitary business means one or more related business organizations where there is a unity of ownership, operation and use. A unitary business can also exist when there is interdependence in functions. The determination of entities comprising a unitary business is determined based on the facts and circumstances in each case.

3. Adjustment of Net Income (17 NCAC 05F.0401)

After the required information has been provided by the corporation, if the Secretary finds as a fact that the a corporation's intercompany transactions lack economic substance or are not at fair market value, the Secretary may redetermine State net income properly attributable to the business carried on in the State. The adjustments the Secretary may make to intercompany transactions not at fair market value or lack economic substance includes a) disallowing deductions in whole or part; b) attributing income to related corporations; c) disregarding transactions; or d) reclassifying income as apportionable or allocable.

4. Combined Returns

Under State law, a corporation is not permitted to elect to file a consolidated or combined income tax return. However, after a corporation has provided the Secretary with the required information regarding its intercompany transactions, if the Secretary finds as a fact that a combined return is be required, the Secretary will notify the corporation in writing to submit a combined return. The corporation must submit the combined return within ninety (90) days of the written notice. The submission of the combined return does not constitute an agreement that the assessment based on the combined return is correct or that additional tax is due.

When a combined return is required, the State net income of the corporation and all members of the affiliated group included in the combined return are apportioned in accordance with G.S. § 105-130.4, and that accurately reports State net income of the business carried on in the State. The Secretary or the corporation may propose a combination of fewer than all members of a unitary group. However, the Secretary cannot require a combination of less than all members of the unitary group without the corporation's consent. Unless agreed otherwise, the combination must include all members of the unitary group, regardless of whether each member is independently doing business in the State.

The steps for preparing a combined income tax return, when requested or permitted by the Secretary, are listed in North Carolina Administrative Code 17 NCAC 05F.0501, 17 NCAC 05F.0502 and 17 NCAC 05F .0503.

5. Statement of Findings

If the Secretary makes an adjustment to net income or requires a combined return under the authority of G.S. § 105-130.5A, the Secretary must provide the corporation a written statement detailing the facts, circumstances and reasons for the adjustment and the proposed method of computing the corporation's State net income. The statement must be provided within ninety (90) days of a proposed assessment made under this section.

6. Economic Substance (17 NCAC 05F.0201 and 17 NCAC 05F.0202)

An intercompany transaction has economic substance if (i) the transaction, or a series of transactions of which the transaction is a part, has one or more reasonable business purposes other than State income tax benefits; and (ii) the transaction, or a series of transactions of which the transaction is a part, has economic effects beyond the creation of State income tax benefits.

The taxpayer has the burden of proving that a transaction meets both prongs of the economic substance test as specified in G.S. § 105-130.5A(g). To prove a transaction, or series of transactions of which the transaction is a part, has a reasonable business purposes other than State income tax benefits, the taxpayer must show that:

a. The business purpose asserted was valid and realistic;

b. The transaction was a reasonable and realistic means to accomplish the asserted business purpose;

c. Evidence exists showing the taxpayer took steps to achieve the asserted business purpose; and

d. The value of the non-State income tax benefits reasonably anticipated from the transaction exceeds the additional cost associated with the transaction.

In general, contemporaneous documentation supports the assertion of a reasonable business purpose. Although not conclusive, a lack of contemporaneous documentation weakens the contention that the asserted business purpose is valid.

7. Economic Effects (17 NCAC 05F.0203)

In proving that a transaction, or a series of transactions of which the transaction is a part, has economic effects other than State income tax benefits, the taxpayer must show by objective evidence that a reasonable likelihood existed at the time the transaction was initiated that there was material benefit of the transaction other than State income tax benefits.

8. Economic Substance Doctrine (17 NCAC 05F.0204)

The Secretary will rely on general principles developed from federal and state tax law cases involving the economic substance doctrine to apply each prong of the two pronged test under

G.S. § 105-130-5A(g), except where case law conflicts with the statute. General principles of the economic substance doctrine include:

a. Economic substance is a prerequisite to a provision allowing deductions;

b. The taxpayer has the burden of proving a transaction has both purpose and substance;

c. The taxpayer has the burden of showing that the form of the transaction accurately reflects its substance and that the deductions claimed are permissible;

d. The economic substance of the transaction is determined based on documentation and data, not the subjective opinions of the taxpayer; and

e. The transactions, not the entities, will be examined for economic substance.

9. Economic Substance Factors (17 NCAC 05F.0205)

In determining whether a transaction has economic substance, ***all*** the following apply:

a. Reasonable business purpose includes any material benefit other than State income tax benefits.

b. Whether the transaction has effects beyond the creation of State income tax benefits may be satisfied by demonstrating material business activity of the entities involved in the transaction. Material business activity will be evaluated in light of and with respect to the type of transactions under review.

c. If the State income tax benefits achieved by the transaction (or series of transactions which transaction is a part) are consistent with legislative intent, such intent is considered in determining whether the transaction has business purpose and economic substance. Examples of legislative intent include a purpose statement directly in the law or explanation in the administrative code.

d. Centralized cash management of an affiliated group is not evidence of a lack of economic substance.

e. Achieving a financial accounting benefit will not be considered as a reasonable business purpose for a transaction if the origin of such benefit is a reduction of State income tax.

The taxpayer has the burden of proof in demonstrating the transaction meets both tests of the economic substance doctrine. The Secretary shall consider all the facts and circumstances in evaluating whether economic substance has been met, including:

a. The reasons for the transaction and whether the transaction was a reasonable means to accomplish the asserted purposes;

b. Expectations of benefits obtained from the transactions;

c. The effects the transaction had on the taxpayer's profits;

d. The existence of a reasonable or realistic potential for profit;

e. The objective economic impact of the transaction other than State income tax savings;

f. The transaction's effect on the taxpayer's State income tax liability, tax liability in other states, and federal tax liability;

g. Whether the method of determining the amount of payment is an industry practice;

h. The change in the business operations of the parties, if any, after the transaction;

i. Whether assets were transferred between or among related parties, the business operations related to specific assets changed after any transfer, whether the transferor retained control over the assets, and the tax consequences;

j. The party or parties who created or developed and presented the ideas which led to the transaction;

k. Whether the contemporaneous documentation explaining the transaction to the taxpayer discussed profit potential in addition to tax benefits;

l. The party or parties that drafted and negotiated the agreements and dictated the terms of the agreement relating to the transaction;

m. Cost-benefit analyses or other studies conducted;

n. Non-tax benefits obtained by the taxpayer as a result of the transaction; and

o. Whether the intercompany transaction resulted in a circular cash flow.

10. When State Income Tax Benefits are Considered (17 NCAC 05F.0206)

State income tax benefits from a transaction are considered by the Secretary in determining whether a transaction has a reasonable business purpose and economic substance when the benefits are consistent with legislative intent, such as when a transaction is in accordance with laws enacted to encourage certain types of activities through tax deductions or credits.

When a transaction generated targeted tax incentives is, in form and substance, consistent with State income tax benefits designed by the General Assembly, the State income tax benefits will be considered by the Secretary in determining whether the transaction has a reasonable business purpose and economic substance.

11. Centralized Cash Management (17 NCAC 05F.0206)

The existence of a centralized cash management system among affiliated group members is not conclusive evidence that a transaction lacks economic substance; however, the Secretary will analyze the transactions for a reasonable business purpose and economic substance.

If a cash management transaction, or series of transactions of which the transaction is a part, creates unreasonably excessive interest expense when compared to industry practice, a shifting of assets, or reclassification of income as nonapportionable or nonallocable, the transaction may be deemed to lack economic substance.

12. Determination of Fair Market Value (17 NCAC 05F.0301)

For purposes of determining whether transactions between members of an affiliated ground are at fair market value, the standards contained in the regulations under section 482 of the Code will be used. Treas. Reg. § 1.482-1 sets out the principle that the primary purpose of section 482 is to prevent the avoidance of taxes. Thus, in general, transactions between related entities should be consistent with the result that would occur between unrelated parties. The regulations provide various methodologies that may be used to determine a correct arm's-length rate; however, no best method is for evaluating transactions is provided. For North Carolina purposes, the nature of the transactions and potential avoidance of State net income taxes as well as the potential circumvention of G.S. § 105-130.7A or other corporate tax statutes will be considered in selecting the best methodology.

The Secretary's authority to make other adjustments is not limited by G.S. § 105-130.5A except the adjustments cannot limit a corporation's option for reporting royalty payments pursuant to G.S. § 105-130.7A. Thus, a methodology that allows for the use of copyright, patent or trademark either without charge or without a separately stated amount is therefore generally inconsistent with the arm's-length standard of section 482 and the option for reporting royalty payments pursuant to G.S. § 105-130.7A. In these cases, the Secretary may separately request or determine the arm's-length royalty rate to comply with G.S. §§ 105-130.5A(o) and 105-130.7A.

The Secretary will consider all the facts and circumstances in determining fair market value including federal and state case law with respect to section 482 of the Code. A transfer pricing study submitted by a taxpayer will also be considered, but will not, by itself, establish that the transaction is at fair market value.

13. Entities Excluded From a Combined Return

The following entities are excluded from a combined return:

a. A corporation not required to file a federal income tax return.

b. An insurance company (except for a captive insurance company) that is:

(i) Subject to tax under Article 8B of Chapter 105;

(ii) Premiums subject to tax under Article 21 of Chapter 58 or similar tax in another state;

(iii) Licensed as a reinsurance company;

(iv) A life insurance company under section 816 of the Code; or

(v) An insurance company subject to tax under section 831 of the code.

"Captive insurance company" means an insurer that is part of an affiliated group that receives more than fifty percent (50%) of net written premiums or amounts received as compensation for insurance from affiliated group members.

c. A tax exempt corporation under section 501 of the Code.

d. An S corporation.

e. A foreign corporation under Code section 7701, other than a domestic branch of such corporation.

f. A partnership, LLC, or other entity not taxed as a corporation.

g. A corporation with eighty percent (80%) or more of gross income from all sources deemed foreign business income under Code section 861(c)(1)(B) in effect July 1, 2009.

14. Proposed Assessments or Refunds, Extensions and Penalties, and Appeals

a. Proposed Assessments or Refunds – The Secretary will issue a proposed assessment or refund if a redetermination of State net income is made under the provisions of G.S. § 105-130.5A. The procedures in Article 9 of Chapter 105 will apply to any such assessment or refund.

b. Extensions and Penalties - The Secretary and the taxpayer may extend any time limit in this section by mutual agreement. If a combined return is not timely submitted after requested, the corporation is subject to the penalties of G.S. § 105-236(a)(3). Penalties will not be imposed except as provided in this section and G.S. § 105-236(a)(5)f.

c. Appeals – The Office of Administrative Hearings will review de novo a final determination by the Secretary under G.S. § 105-130.5A. This review will evaluate whether (i) the taxpayer's separate return fails to properly report State net income as a result of intercompany transactions due to a lack of economic substance or fair market value of the transactions; (ii) the Secretary's method of determining State net income is appropriate; and (iii) if a combined return was determined to be required, whether other adjustments rather than a combined return are adequate to correctly reflect State net income.

15. Voluntary Redetermination

If the Secretary believes that because of intercompany transactions, a corporation's State net income is not accurately reported on a separate return, but without making a finding that those transactions lack economic substance or are not at fair market value, the Secretary and corporation may jointly agree to an alternative filing methodology to accurately reflect State net income. The Secretary is authorized to allow any reasonable method for these purposes.

16. Request to File a Combined Return

A corporation cannot voluntarily elect to file a combined income tax return. However, a taxpayer may make a written request for advice from the Secretary regarding whether a corporation's State net income would be subject to adjustment or a combined return required under G.S. § 105-130.5A under specific facts and circumstances. The Secretary may request any information necessary to provide such advice, but must provide specific advice within 120 days of the receipt of all necessary information. G.S. § 105-264 governs the effect of this advice.

For more information regarding how to request a redetermination of the corporation's State net income on a combined return, see:

http://www.dornc.com/taxes/corporate/impnotice_10-11b.pdf

17. Franchise Tax

Unless the Secretary authorizes a combined group to file a combined franchise tax return under G.S. § 105-122, each corporation that is doing business in this State under G.S. § 105-114(b)(3) is subject to franchise tax, and must file a franchise tax return and pay the tax due.

Any corporation that is included in a combined income tax return but is not doing business in this State under G.S. § 105-114(b)(3) is not subject to franchise tax.

The principal member files its franchise tax return on the combined group's CD-405. All other combined group members must file a separate CD-405 and compute its separate franchise tax, if required, include $0 on the "Net Taxable Income" and "NC Net Income Tax" lines of the CD-405, and attach a statement with the return that (i) indicates its income is included on a combined return filed by a principal member; and (ii) identifies the name and federal EIN number of the principal member.

If the corporation filing the franchise tax return is a multistate taxpayer, then the apportionment factor used in determining the Net Worth base is calculated using its separate entity property, payroll, and sales, before intercompany eliminations. Schedule O of the CD-405 must reflect the entity's apportionment factor for franchise tax purposes.

Q. Partnership and the Corporate Partner (17 NCAC 05C.1700)

1. Reporting Partnership Net Income

A corporation that is a member of a partnership or joint venture doing business in North Carolina is subject to North Carolina income tax and is required to include in the total net income subject to apportionment and allocation its share of the partnership's net income or net loss to the same extent required for federal income tax purposes.

2. Apportionable Income or Nonapportionable Income

Whether a corporate partner's share of the partnership's net income is classified as apportionable income or nonapportionable income depends upon the facts in each case. In general, all income from transactions and activities that are dependent upon or contribute to the operations of a taxpayer is apportionable. Income from unrelated business activities that make up a discrete business enterprise is nonapportionable. When classified as apportionable income, the corporate partner's apportionment factors include its proportionate share of the partnership's property, payroll, and sales. If such income is classified as nonapportionable income, it is included in the corporate partner's net taxable income and allocated in accordance with the allocation provisions of G.S. § 105-130.4.

R. Filing of Returns and Payment of Taxes

1. Time and Place for Filing

General business corporation franchise and income tax returns are due on the 15th day of the fourth month following the close of the income year and are filed on a combination return form. A short period return required as a result of a corporation becoming a member of a consolidated group for federal purposes may be filed on the due date of the federal short period return. However, interest is due beginning one hundred five (105) days following the last day of the short period.

A corporation organized outside the United States that files a federal income tax return pursuant to IRC § 6072(c) is required to file its return on or before the 15th day of the seventh month following the close of its income year.

Returns of agricultural cooperatives are due on or before the 15th day of the ninth month following the close of the income year.

Tax-exempt organizations described in G.S. § 105-130.11(a)(1) and (a)(3) through (a)(8) which are required to file a return under G.S. § 105-130.11(b) must file a calendar year return on or before May 15 of the following year and a fiscal year return on or before the 15th day of the fifth month following the close of the fiscal year.

For purposes of determining the due date of tax returns and tax payments an income year ending on any day other than the last day of the month shall be deemed to end on the last day of the calendar month ending nearest to the last day of a taxpayer's actual income year.

Example 1: The short tax period for Corporation X ends on May 14. The short period return and tax payment are due on August 15 (one hundred five (105) days after April 30.) On

August 15, Corporation X may apply for an extension of time to file the short period return; however, to avoid penalty and interest, one hundred percent (100%) of the tax due must be paid by August 15.

Example 2: The short tax period for Corporation Y ends on May 16. The short period return and tax payment are due on September 15 (one hundred five (105) days after May 31). On September 15, Corporation Y may apply for an extension of time to file the short period return; however, to avoid penalty and interest, one hundred percent (100%) of the tax due must be paid by September 15.

Returns should be filed with the North Carolina Department of Revenue, P.O. Box 25000, Raleigh, North Carolina 27640-0500, or at one of the Department's local branch offices located in principal cities throughout the State.

2. Extension of Filing Date

Prior to the date set by statute for filing a corporation's franchise and income tax return, a corporation may apply for an extension of time for filing its return.

For additional detailed information concerning the requirements for obtaining an extension of time for filing a corporate franchise and income tax return, see the Departments website at:

http://www.dor.state.nc.us/downloads/corporate.html

3. Payment of Taxes

Except to the extent income tax is required to be paid through estimated tax payments, the full amount of franchise and income taxes is payable on the statutory filing date, without regard to extensions. Remittances should be made payable to the *N. C. Department of Revenue* in U.S. currency from a domestic bank. For information on paying electronically, see:

http://www.dornc.com/electronic/cdv.html

4. Interest and Penalties

Interest accrues at the rate established pursuant to G.S. § 105-241.21 on any tax paid after the date set by statute for filing the return. The statutory due date for filing a corporation franchise and income tax return is the fifteenth day of the fourth month following the close of the corporation's income year A failure to file penalty of five percent (5%) of the total taxes due is incurred each month a return is delinquent, the maximum penalty being twenty-five percent (25%). In addition the corporation is subject to the failure to pay by the due date penalty of ten percent (10%).

5. Contribution of Income Tax Refund to North Carolina Wildlife Fund

Corporations may elect to contribute part or all of its overpayment to the North Carolina Nongame and Endangered Wildlife Fund on the specified line of the corporate income tax return. The election to contribute to the Fund cannot be changed after the return is filed.

If the corporation is not due a refund, it may still contribute to this Fund by mailing your donation directly to the:

North Carolina Wildlife Resources Commission
1701 Mail Service Center
Raleigh, North Carolina 27699-1701.

Checks should be made payable to the Nongame & Endangered Wildlife Fund. For more information about the Fund, see:

http://www.ncwildlife.org/GiveDonate.aspx

6. Contributions of Income Tax Refund or Payment to the North Carolina Education Endowment Fund

The North Carolina Educational Endowment Fund was created to provide additional support and funding for K-12 public schools. A corporation entitled to a refund of corporate income tax may elect to designate all or part of the refund to the North Carolina Education Endowment Fund. The designation must be made by the corporation on the specified line of the income tax return. The election to contribute to the Fund cannot be changed after the return is filed.

In addition, if the corporation is not due a refund, it may still contribute to this Fund by either making a contribution with the corporate tax return using Form NC-EDU, or by mailing a donation directly to:

North Carolina Department of Public Instruction
Cash Collections
6331 Mail Service Center
Raleigh, NC 27699-6331

Checks should be made payable to the North Carolina Department of Public Instruction and should indicate the contribution is for the North Carolina Education Endowment Fund.

To obtain Form NC-EDU, see:

https://eservices.dor.nc.gov/vouchers/ncedu.jsp

7. Overpayment Credited To Next Year's Tax

A corporation may elect to have an income tax refund applied to estimated income tax for the following year. A return reflecting an election to apply a refund to estimated income tax for the following year must be filed by the last allowable date for making estimated tax payments for that year for the election to be valid.

If a corporation makes a valid election, the corporation may not revoke the election after the return on which the election is made has been filed.

8. Exceptions to the General Statute of Limitations (G.S. § 105-241.6(b)(5))

G.S. § 105-2416(b)(5) provides an exception to the general statute of limitations for obtaining a refund in the case of a contingent event. A contingent event is litigation or state tax audit that commenced prior to the expiration of the statute of limitations which prevents a taxpayer from filing an accurate or definite request for refund by the expiration of the statute of limitations. Written notice must be provided to the Secretary prior to the expiration of the statute of limitations for refund. Either Form NC-14 or written correspondence can be submitted.

For further details and to obtain a Form NC-14, please visit the web site at:

http://www.dornc.com/taxes/certainevents.html
http://www.dornc.com/forms/nc14.pdf

S. Extension of Time for Filing Return (G.S. § 105-263)

1. Application For Extension (17 NCAC 05C.2004)

An extension of time to file the franchise and income tax return may be granted for six (6) months providing an extension application is timely filed.

2. Form to be Used

Form CD-419 is the application for extension form that must be filed before an extension of time to file the return can be granted. The form must be filed with the Department on or before the fifteenth day of the fourth month following the close of the income year. To obtain a form, see:

http://www.dor.state.nc.us/downloads/blank/CD419.pdf

3. Payment Due

Payment of franchise and income tax due is not required with the extension. An extension of time may be granted even if the request for extension is not accompanied by a payment of the taxes due. However, the extension of time for filing a franchise tax return or an income tax return does not extend the time for paying the tax due. The penalty of ten percent (10%) for failure to pay the tax when due will be applied to any tax not paid by the original due date. In addition, interest at the statutory rate established under G.S. § 105-241.21 is accrued from the original due date to the date the tax is paid.

For filing extensions and payments electronically, see:

http://www.dor.state.nc.us/electronic/cd419.html

T. Dissolutions and Withdrawals (Articles 14 and 15 of G.S. Chapter 55, G.S. 105-127)

1. Dissolutions (17 NCAC 05C.2101)

a. Voluntary Dissolution

A corporation is dissolved immediately upon the effective date of filing the articles of dissolution with the Secretary of State. Although a tax clearance is no longer a part of the Secretary of State's voluntary dissolution process, this does not relieve the corporation of its liability to file all tax reports and returns due and pay all taxes due the Department of Revenue. The Department will continue to notify a corporation of any unfulfilled tax requirements.

After the end of the year in which a taxpayer voluntarily dissolves, the dissolved corporation is not subject to the annual franchise tax unless the corporation engages in business activities not connected to winding up and liquidating its business and affairs.

b. Administrative Dissolution

The Secretary of State may administratively dissolve corporations for various non-compliance reasons. Once this dissolution occurs, the corporation may apply to the Secretary of State for reinstatement. The administrative dissolution does not relieve the corporation of its liability to file all reports and returns due and pay all taxes due the Department.

2. Withdrawals

Before a foreign corporation is permitted to withdraw its certificate of authority to do business in North Carolina, it must file all tax reports and returns due and pay all taxes due. The same general procedure of notifying a corporation that is dissolving of any unfulfilled tax requirements will also be followed for corporations withdrawing from North Carolina.

Note**:** A corporation that is dissolving or withdrawing is required to file a final income tax return within the statutory due dates for filing returns after the close of business in this State. In this final return, the corporation must include in income any unrealized, deferred or unreported profit from installment sales and pay the tax due with such return. For information on statutory due dates, see *Subject "Filing of Returns and Payment of Taxes."*

U. Suspensions and Reinstatements

1. Suspension of Corporate Charter (G.S. § 105-230)

A corporation that fails to file any report or return or to pay any tax or fee as a corporation incorporated under the laws of this State, or as a foreign corporation domesticated in or doing business in this State shall be certified for suspension ninety (90) days after the time prescribed for filing such return, report or payment. After the Secretary of Revenue certifies these facts to the Secretary of State, the articles of incorporation of the corporation will be suspended. All the powers and privileges of the corporation will cease upon the suspension. Corporate powers exercised after the suspension of the articles of incorporation or the certificate of authority will subject the corporation to penalty.

2. Reinstatement of Corporate Charter

A domestic corporation (incorporated in North Carolina) certified for suspension of its Corporate Charter to the Secretary of State's office may be reinstated without regard to the elapsed suspension period provided all returns are filed with remittance of the tax, interest and penalty due, plus the reinstatement fee of twenty-five dollars ($25.00).

A foreign corporation (incorporated outside North Carolina) certified for suspension of its Certificate of Authority to the Secretary of State's office may be reinstated without regard to the elapsed suspension period provided all returns for years since securing the Certificate and/or since commencing business in this State are filed with remittance of tax, interest and penalty due, plus the reinstatement fee of twenty-five dollars ($25.00).

V. Exempt Corporations (G.S. § 105-130.11 and G.S. § 105-130.12)

1. Preliminary Statement

Some corporations are fully exempt from income and franchise taxes, whereas others are conditionally or partially exempt, subject to the conditions set out in *Item 3* of this section.

2. Corporations Fully Exempt

These corporations qualify for the full income tax exemption:

- Insurance companies subject to the tax on gross premiums are exempt from income tax.
- Cooperative banks without capital stock and organized and operated for mutual purposes without profit, telephone membership corporations organized under Chapter 117 of the General Statutes of North Carolina, and electric membership corporations are exempt for income taxes.

3. Corporations Conditionally or Partially Exempt

The following organizations and any organization exempt from federal income tax under the Code are exempt from both franchise tax and corporation income tax (to the extent exempt from federal income tax) if they are not organized for profit, and if no profit inures to the benefit of any member, shareholder or other individual:

a. Fraternal societies, orders or associations. To qualify for income tax exemption, the organization must (1) operate under the lodge system or for the exclusive benefit of members of a fraternity that is operating under the lodge system; and (2) provide life, sick, accident or other benefits to the members or their dependents.

b. Corporations organized or trusts created for religious, charitable, scientific or educational purposes, including cemetery corporations and organizations for the prevention of cruelty to children and animals.

c. Business leagues, chambers of commerce, merchants associations and boards of trade.

d. Civic leagues or organizations operated exclusively for the promotion of civic welfare.

e. Clubs organized and operated exclusively for pleasure, recreation and other non-profit purposes.

f. Mutual hail, cyclone and fire insurance companies; mutual ditch, irrigation, canning and breeding associations; mutual or cooperative telephone companies; and like organizations of a purely local character which derive their entire income from assessments, dues or fees collected from members for the sole purpose of meeting expenses.

g. Farmers' marketing associations operating as sales agents to market the products of members or other farmers, and to return to them the proceeds, less the necessary selling expenses, on the basis of the quantity of product furnished by them.

h. Pension, profit-sharing, stock bonus and annuity trusts established by employers for the purpose of distributing both the principal and income thereof exclusively to eligible employees or the beneficiaries of such employees. There must be no discrimination in favor of any particular employee. The interest of individual employees must be irrevocable and non-forfeitable to the extent of contributions by such employees. Exemption of a trust under the Federal income tax law is a *prima facie* basis for granting exemption from North Carolina franchise and income taxation.

i. Condominium associations, homeowner associations or cooperative housing corporations not organized for profit, the membership of which is limited to the owners or occupants of residential units in the condominium, housing development, or cooperative housing corporation.

j. Cooperative or mutual associations formed under Section 54-124 of the General Statutes to conduct agricultural business on the mutual plan, and marketing associations formed under Section 54-129 of the General Statutes are required to file an annual income tax return on Form CD-418 and to pay tax on any net income not refunded on a patronage basis on or before the 15th day of the ninth month after close of the income year. They are also required to furnish with this return the names and addresses of all persons paid a patronage refund of ten dollars ($10.00) or more, and the amount of the refund paid to each.

k. North Carolina political organizations are exempt from franchise tax, but must file a corporate income tax return if the organization has gross taxable income of more than one hundred dollars ($100). Organizations must first complete federal Form 1120-POL to determine the organization's federal taxable income. The political organization may attach a copy of its federal return instead of completing Schedule G of Form CD-405. If North Carolina adjustments are applicable, Schedule H must also be completed.

In general a NC political organization must file Form CD-405 by the statutory due date for filing returns. The due date may be extended if the extension, Form CD-419, is received timely. Interest and applicable penalties may be imposed if the organization is required to file Form CD-405 and fails to file the form by the due date. For information on statutory due dates, see Subject "Filing of Returns and Payment of Taxes."

Forms CD-405 and CD-419 are available online at:

http://www.dornc.com/downloads/corporate.html

4. Organizations Exempt from Federal Income Tax but not Covered by a Specific Section of the N. C. Statutes

The non-profit organizations and cooperative and mutual associations listed above are not exempt from tax on income received in excess of one thousand dollars ($1,000) annually from business activities not substantially related to the functions for which the organizations or associations were formed. However, they are fully exempt from tax on the following income unless such income is classified as unrelated business taxable income under the Code: Interest, royalties, dividends and rentals; income from a business operated without cost to the organization; income from the sale of merchandise donated to the organization; income from a business conducted by a religious, charitable, scientific, or educational organization for the convenience of its members; income derived from research performed by a college, university or hospital, or performed for a governmental unit or agency, or performed by a research organization primarily for the benefit of the public, unless such income is deemed to be related income by the IRS.

Homeowner associations are taxed on gross income (excluding membership income), less allowable deductions. The one thousand dollars ($1,000) specific deduction does **not** apply to homeowner associations.

5. Regulated Investment Companies and Real Estate Investment Trusts

These are organizations or trusts which qualify under the United States Code as a "regulated investment company" or a "real estate investment trust" and file an election to be treated as such with the Revenue Department.

They are exempt from income tax only on that part of their net income which is distributed or declared for distribution to shareholders during the income year or by the time required by law for the filing of the return for the income year including the period of any extension of time granted for filing such return.

Captive Real Estate Investment Trusts are required to add to federal taxable income the dividend paid deduction allowed under the Code. A captive REIT is defined as one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to NC corporate income tax. REITs owned by other REITs or listed Australian property trusts are excluded from the definition of captive REIT.

6. Real Estate Mortgage Investment Conduits (REMIC)

Organizations which qualify under the Code as Real Estate Mortgage Investments Conduits (REMIC) are exempt from franchise tax, and are also exempt from income tax to the extent the REMIC is exempt from income tax under the Code.

7. Limited Liability Company (LLC)

The "North Carolina Limited Liability Company Act" (Chapter 57C of the North Carolina General Statutes) permits the organization and operation of limited liability companies (LLC). An LLC is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership.

North Carolina recognizes the Internal Revenue Service "check the box" regulations for LLC's. Under the federal regulations, a domestic LLC that is not mandatorily classified nor elects to be classified as a corporation is classified by default as a partnership if it has two or more members. A domestic single-member LLC that is not mandatorily classified nor elects to be classified as a corporation is disregarded as an entity separate from its single owner.

If the only member of a domestic LLC that is disregarded as an entity separate from its single owner is a corporation, the LLC income and expenses are reported on the corporation's return, usually Form 1120 or Form 1120S.

If the only member of the LLC that is disregarded as an entity separate from its single owner is an individual, the activities of the LLC are treated in the same manner as those of a sole proprietorship of the owner.

Each corporate member of an LLC doing business in North Carolina has nexus in North Carolina; however, not every corporate member is required to file North Carolina corporate income and franchise tax returns. The determining factors are the LLC's entity classification and each corporate member's other activities in this State.

If an LLC is treated as a partnership for federal income tax purposes, each corporate member is required to file a corporate income and franchise tax return even if there are no other activities in the State since the LLC's income, assets, and activities flow through to the members of the

LLC. The treatment of a corporate member of an LLC that is treated as a partnership is identical to the treatment of a corporation that is a partner in a partnership.

If the LLC is treated as a corporation for federal tax purposes and each corporate member's only connection to North Carolina is its ownership interest in the LLC, the corporate member(s) is not required to file a North Carolina corporate income and franchise tax return even though the corporate member(s) has nexus in North Carolina as a result of its membership in the LLC. The corporate member(s) is not required to file in this circumstance because the LLC reports its North Carolina income at the entity level and the apportionment attributes of the LLC do not flow through to the corporate member(s) as is the case when the LLC is disregarded or is treated as a partnership.

If the LLC is treated as a corporation for federal tax purposes and each corporate member has activities in this State, in addition to its ownership interest in the LLC, that make the corporate member subject to the franchise tax, the corporate member(s) is required to file a corporate income and franchise tax return.

An LLC is subject to the same provisions that apply to corporations relating to suspension of charter, penalties for operating with a suspended charter and reinstatement rights after suspension of charter.

8. Proof of Exemption

A corporation is not exempt from tax merely because it is not organized and operated for profit. Being formed under Chapter 55A of the General Statutes (the "Non-Profit Corporation Act") does not automatically entitle a corporation to exemption.

Every corporation claiming exemption as a non-profit organization or as a cooperative or a mutual association must furnish the Secretary of Revenue a copy of its Articles of Incorporation and bylaws, and any other document or information, such as a trust agreement, which may be requested. After reviewing the evidence submitted, the Secretary will notify the corporation whether or not it qualifies for exemption.

The principal factors which are considered in determining taxable status are the corporation's character; its purposes, the activities in which it will engage; the sources and disposition of its income; whether any of its net income may inure to any private individual; and what disposition will be made of its assets in the event of dissolution.

It is the policy of the Department, except when the nonprofit nature and intent of the corporation is otherwise clearly indicated, to require that the Articles of Incorporation or bylaws of the corporation contain a specific stipulation that no part of its net income shall inure to the benefit of any private member, shareholder or other individual, either during the existence of the corporation or in the event of its dissolution.

9. Notification of Change In Purposes or Operations

If any change is made in its purposes or method of operation that affects its taxable status, an exempt corporation should promptly notify the Revenue Department of such change.

W. Reporting Federal Changes (G.S. § 105-130.20, G.S. § 105-241.6, G.S. § 105-241.8, and G.S. § 105-241.10)

1. Requirement for Reporting Federal Income Tax Changes

If the amount of taxable income of any corporation subject to tax in this State, as reported or reportable to the United States Treasury Department, is changed by the U.S. Government, such corporation must file a return under oath reflecting such change within six months after receipt of the Federal report. A taxpayer that fails to file a return within 6 months is subject to the penalties in G.S. § 105-236 and forfeits its rights to any refund due by reason of the federal determination.

A federal determination means a correction or final determination by the federal government of the amount of federal tax due.

2. Statute of Limitations on Assessments or Refunds

When a corporation files a timely return reflecting a federal determination, an assessment of tax must be proposed within one year after the return is filed or within three years of when the original return was filed or due to be filed, whichever is later.

If the corporation does not file the return within the required time, an assessment of tax must be proposed within three years from the date of the receipt by the Department of Revenue of the final report of federal determination from the U.S. government.

When a timely return reflecting a federal determination results in an overpayment of tax, the period in which a refund may be requested is one year after the return reflecting the federal determination is filed, if filed timely, or three years after the original return was filed or due to be filed, whichever is later.

3. Limits on Refunds and Assessments after a Federal Determination

When the Department receives a timely return or report reflecting a federal determination that alters the amount of State tax payable and the general statute of limitations has expired, the Secretary may assess for additional tax only if the additional tax is the result of the adjustment reflected in the federal extension. In addition, a taxpayer is only allowed a refund if such refund is the result of an adjustment related to the final determination of federal tax changes. If the taxpayer does not timely report the federal changes, the Department may also make any other changes based on any facts or evidence brought to his attention or shall otherwise acquire, whether or not such facts or evidence were considered by the federal government. This is the case regardless of whether or not an adjustment has been made previously for the taxable year affected by the federal changes.

4. Fraud Provisions on Federal Changes

When there is a federal adjustment made in a corporation's income tax return and a fraud penalty is assessed by the federal government, the State may open the year for adjustments on the basis of either fraud or the federal assessment. The penalty for fraud is fifty percent (50%) of the total deficiency. In such case and if the corporation has not filed a State return, the fraud penalty and delinquency penalty of five percent (5%) per month (twenty-five percent (25%) maximum, five dollars ($5.00) minimum) may be assessed.

X. Domestic International Sales Corporation (G.S. §§ 105-130.3, 105-130.4, and 105-262)

1. Doing Business Activities of DISC (17 NCAC 05C.2401)

Every Domestic International Sales Corporation (DISC) doing business in this State shall be subject to income tax in this State. A DISC shall be considered to be doing business in this State if the business activities of the DISC are principally conducted, managed or directed in or from this State. If a DISC transacts substantial business with a supplier, other than its parent company, whose business activities are primarily conducted, managed or directed in or from this State, the DISC shall be considered to be doing business in this State. The entire business of a DISC doing business in this State shall be deemed to have been transacted or conducted within this State if such DISC is not subject to a tax measured by net income in another state or would not be subject to a tax measured by net income in any other state if such other state had a tax measured by net income. The fact that a DISC is incorporated in another state shall not of itself show that it is subject to a tax measured by net income in such other state.

2. Determination of DISC Net Income

The net income of a DISC shall be determined in accordance with the Revenue Laws of this State.

3. Apportionment of DISC Net Income

The net income of a DISC subject to a tax measured by net income both within and without this State shall be apportioned to this State by use of the applicable apportionment formula set out in G.S. § 105-130.4. The ratio determined for apportioning the net income of the DISC shall be computed by including the property, payroll and sales of the parent corporation in the respective factors of the DISC. Where the DISC conducts substantial business with a supplier(s) other than its parent, the property, payroll and sales of the supplier(s) may be included in the respective factors of the DISC to the extent prescribed by the Secretary of Revenue. The property, payroll and sales of the parent corporation or other supplier(s) included in the factors of the DISC shall be for the period ending with or within the income year of the DISC. Further, the Secretary of Revenue may prescribe such other method or methods as may be deemed necessary to attribute to this State a fair and reasonable profit that would normally arise from the operation of such businesses conducted on a true arms-length basis.

Y. S Corporations (G.S. § 105-131)

1. Corporations Required to File

Every corporation required to file a franchise and income tax return in North Carolina which has a valid "S election" in effect under the Internal Revenue Code Section 1362, must file a North Carolina S corporation return.

2. Forms to be Used for Filing

S corporations doing business in North Carolina use Form CD-401S to report activities. Form CD-401S is available at the Department's website at:

http://www.dornc.com/downloads/corporate.html

3. Return and Payment Due

The due date of the S return is the 15th day of the fourth month following the close of the income year. The liability for franchise tax is payable on the statutory due date of the return, without regard to extension. Any income tax payment made on behalf of nonresident shareholders included in a composite return is also due at that time.

4. Extensions (Form CD-419)

An extension of time to file the S corporation's franchise and income tax return will be granted for six (6) months provided the application is timely filed. Form CD-419 is available at the Department's website at:

http://www.dornc.com/electronic/cd419.html

5. Election

The federal election authorizing S corporation status is recognized for state purposes. There is no provision to elect a different filing status for State purposes; each S corporation must file as an S corporation for State income tax purposes. The S corporation status will terminate for North Carolina purposes at the same time and for the same taxable period(s) such termination is effective for federal filing purposes.

6. Nonresident Shareholder Agreement (Form NC-NA)

An S corporation with nonresident shareholders is required to submit with the first North Carolina S return an agreement for each nonresident shareholder. The agreement, Form NC-NA, is to be signed by the shareholder who agrees to be subject to the income tax laws of this

State and to be liable for the tax on the pro rata share of S corporation income attributable to such individual in this State. The individual is liable at the individual rate(s) on the portion of North Carolina income attributed to those nonresident shareholders who have filed Form NC-NA.

Note**:** If the S corporation fails to timely file the shareholder agreement(s) for nonresidents, the corporation becomes liable for income tax at the individual single rate on the portion of the North Carolina income attributed to those shareholders not complying with this requirement.

Form NC-NA is available from the Department's website at:

http://www.dornc.com/downloads/corporate.html.

7. Franchise Tax, Schedules A, C, D and E of Form CD-401S (G.S. § 105-122)

S corporations determine their franchise tax liability in the same manner as all other general business corporations. Franchise tax schedules A, C, D, and E pertain to the corporation franchise tax base and the amount of tax liability. There is no difference between an S corporation and a C corporation with respect to the franchise tax requirement or liability.

Additional information concerning the computation of the franchise tax schedules can be found under the subject, "General Business Corporations," of the franchise tax section of this publication and in the Corporation Franchise and Income Tax Instructions, CD-415, used by all other corporations.

8. Corporate Income of S Corporations Taxed to Shareholders (G.S. § 105-131)

An S corporation is not subject to the tax levied under G.S. § 105-130.3. Rather, the S corporation's income and expenses are divided among and passed through to its shareholders, who then must report the income and expenses on their State individual or trust tax returns. The pro rata share of resident and nonresident shareholders in the income and expenses of an S Corporation is subject to the adjustments under individual income tax law (G.S. 105-153.5 and 105-153.6).

9. Composite Return for Nonresident Shareholders (G.S. § 105-131.7(b))

If the S corporation has shareholders who are nonresidents of North Carolina, the corporation may file a composite return that reflects the state taxable income of each nonresident and the amount of tax due. The composite return is available for nonresident shareholders only. A remittance of the total tax due on behalf of nonresident shareholders is made with the return, CD-401S, when filed.

A nonresident individual shareholder is not required to file a North Carolina individual income tax return if the only income in North Carolina is reported by the S corporation. A nonresident trust shareholder, other than a grantor trust, is required to file a North Carolina fiduciary income tax return even if its only income in North Carolina is reported by the S Corporation.

Z. Qualified Subchapter S Subsidiaries

1. Preliminary Statement

The Federal Small Business Job Protection Act of 1996 allows S corporations to own qualified S corporation subsidiaries, (QSSS). The parent must elect qualified S corporation treatment for its one hundred percent (100%) owned subsidiary. For federal income tax purposes, a QSSS is not treated as a separate corporation, but rather all the subsidiary's assets, liabilities, and items of income, deductions and credits are treated as those of the S corporation parent. North Carolina follows the federal treatment for income tax purposes and recognizes all the income and expense items as belonging to the parent corporation.

(Reference: North Carolina Technical Advice Memorandum dated August 1, 1997, Qualified Subchapter S Subsidiaries, (CTAM 97-13)).

2. Parent S Corporation Nexus

All of the subsidiary's activities will be attributed to the parent for purposes of determining whether the parent is doing business in North Carolina.

3. Apportionment Factors

The parent S corporation must aggregate and include the subsidiary's items of income, loss, and deductions before determining the parent's apportionable or allocable income. The parent S corporation must also include the subsidiary's property, payroll and sales in calculating its apportionment factors. The parent S corporation must use the same apportionment factor that was used to apportion the combined income of the parent and subsidiaries to determine its capital stock, surplus and undivided profits franchise tax base. The QSSS does not calculate an apportionment factor for income tax since its income is taxed at the parent level. However, it must calculate its apportionment factor using its own property, payroll, and sales to determine its capital stock, surplus and undivided profits franchise tax base.

4. Franchise Tax Returns

Each QSSS and each parent S corporation doing business in this State must file a separate franchise tax return for each taxable period based on their own separate attributes. The assets, liabilities, income, deductions or credits of the parent and the qualified S corporation are not combined for this purpose. A franchise tax return must be filed even if the resulting liability is the minimum franchise tax.

5. Shareholders

Shareholders in an S corporation parent with a QSSS doing business in this State must report income attributable to this State in accordance with Part 1A of Article 4 of Chapter 105 of the General Statutes.

III. INSURANCE PREMIUMS TAX
(Article 8B)

A. General Information (G.S. 105-228.4A, 105-228.5, 105-228.8)

North Carolina levies several types of insurance premium tax upon insurers, both domestic and foreign, for the privilege of engaging in insurance business. Foreign insurers taxed under G.S. 105-228.5 are subject to retaliatory provisions.

B. Insurance Companies Subject to the Tax under G.S 105-228.5 (G.S. 105-228.5, G.S. 58-6-25)

All insurers as defined in G.S. 58-1-5, all hospital, medical, and dental service insurers organized as Article 65 corporations under G.S. 58-65, and all self-insurers organized and licensed in accordance with G.S. 58-47, G.S. 97-5 or G.S. 97-93, including groups of employers who have pooled their liabilities and employers that carry their own risks, that are doing business in this State are subject to gross premium tax pursuant to G.S. 105-228.5 and the retaliatory tax provisions set forth in G.S. 105-228.8.

All insurers, all hospital, medical and dental service insurers organized as Article 65 corporations, all self-insurers, and all health maintenance organizations are subject to the insurance regulatory charge pursuant to G. S. 58-6-25.

C. Captive Insurance Companies Subject to the Tax under G.S. 105-228.4A (G.S. 105-228.4A)

All captive insurance companies as defined in G.S. 58-10-340 doing business in this State are subject to gross premium tax pursuant to G.S. 105-228.4A. In the case of a branch captive insurance company, only the branch business of the company is subject to gross premium tax. Two or more captive insurance companies under common ownership and control are taxed under G.S. 105-228.4A as a single captive insurance company. Captive insurance companies are not subject to the insurance regulatory charge levied in G.S. 58-6-25 or the retaliatory tax levied under G.S. 105-228.8.

D. Types of Tax and Charges (G.S. 105-228.4A, G.S. 105-228.5, G.S 58-6-25)

There are several types of insurance premium tax applied, according to the type of insurance company and the type of insurance written. Gross Premium Tax, Additional Tax on Property Coverage Contracts, and Retaliatory Tax are types of insurance premium tax reported. Tax rates, according to the type of insurance written, apply to each type of tax. Premium tax return forms to be used in filing premium tax returns are available on the Department's website at http://www.dornc.com/downloads/insurance.html. Other sources of the forms, if used, must obtain prior approval. Supplemental schedules as required by the Department of Revenue must be attached to all returns filed.

Insurers taxed under G.S. 105-228.5, Article 65 corporations, health maintenance organizations, and self-insurers are required to pay an Insurance Regulatory Charge in addition to all other fees and taxes. The Insurance Regulatory Charge is a percentage of the gross premium tax liability, exclusive of any additional taxes imposed by G.S. 105-228.8, any credits allowed under G.S. 105-228.5A or G.S. 97-133(a), and any other credits allowed under Chapter 105 of the General Statutes, for the taxable year. The insurance regulatory charge does not apply to captive insurance companies taxed under G.S. 105-228.4A.

E. Tax Basis for Insurers taxed under G.S. 105-228.5 (G.S. 105-228.5)

The tax imposed on an insurer taxed under G.S. 105-228.5 is based on gross premiums from business done in the State during the calendar year. Finance charges are included in gross premiums.

In the case of life insurance contracts, including supplemental contracts providing for disability benefits, accidental death benefits, or other special benefits that are not annuities and excluding contracts of reinsurance, gross premiums from business done means all premiums collected in the calendar year. Insurers are allowed to deduct premiums refunded on policies rescinded for fraud or other breach of contract and premiums that were paid in advance on life insurance contracts and subsequently refunded to the insured, premium payer, beneficiary, or estate.

For all other contracts of insurance, including contracts of insurance required to be carried by the Workers' Compensation Act and excluding contracts of reinsurance, gross premiums from business done in the State means all premiums written, or the equivalent thereof in the case of self-insurers under the Workers' Compensation Act, for contracts covering property or risks in this State, whether the premiums are designated as premiums, deposits, premium deposits, policy fees, membership fees, or assessments.

In allocating premiums to this State, no distinction is made between the allocation of premium income from a group insurance policy and premium income from individual insurance policies. Gross premiums from group policies providing coverage for individuals living in this State are taxable by this State and should be allocated to North Carolina regardless of the address of the policyholder, policy owner, or beneficiary. The determining factor is residence of the insured. The allocation exception in G.S. 105-228.5(b1)(1) does not apply with respect to premium income from insurance policies issued to owners, including trusts, located outside North Carolina but covering North Carolina risks.

If, for any tax year, returned premiums exceed gross premiums collected, insurers may reduce taxable premiums to zero. The general statutes do not provide for the carryforward of any unused returned premiums or the refund of premium taxes on any unused return premiums.

When insurers are ordered by the Department of Insurance to establish escrow accounts of possible premium overcharges, reductions in gross premiums are allowed after any refunds have been paid to insureds, not when the escrows are established.

An insurer taxed under G.S. 105-228.5 may exclude the following in determining gross premiums from business done in this State:

- Premiums properly reported and properly allocated as being received from business done in some other nation, territory, state, or states.
- Premiums received from policies written in federal areas for persons in military service who pay premiums by assignment of service pay.
- Premiums received from policies or contracts issued in connection with the funding of a pension, annuity, or profit-sharing plan qualified or exempt under section 401, 403, 404, 408, 457, or 501 of the Internal Revenue Code as defined in G.S. 105-228.90.
- Premiums or considerations received from annuities, as defined in G.S. 58-7-15.
- Funds or considerations received in connection with funding agreements, as defined in G.S. 58-7-16.
- Medicaid or Medicare premiums, to the extent federal law prohibits their taxation.

F. Tax Basis for Captive Insurers taxed under G.S. 105.228.4A (G.S. 105.228.4A)

The tax imposed on captive insurance companies taxed under G.S. 105-228.4A is based on all direct premiums and assumed reinsurance premiums of a captive insurance company domiciled in the State. In the case of a multiyear policy or contract, the premiums must be prorated among the years covered by the policy or contract.

Taxable direct premiums do not include amounts paid to policyholders as return premiums. Return premiums include dividends on unabsorbed premiums or premium deposits returned or credited to policyholders. The premium tax on assumed reinsurance premiums does not apply to premiums for risks or portions of risks that are subject to taxation on a direct basis under G.S. 105-228.4A(e). The tax on assumed reinsurance premiums does not apply in connection with the receipt of assets in exchange for the assumption of loss reserves and other liabilities of one insurer by another insurer if the two insurers are under common control and the Commissioner of Insurance verifies 1) the transaction between the insurers is part of a plan to discontinue the operations of one of the insurers and 2) the intent of the insurers is to renew or maintain business with the captive insurance company.

G. Tax Rates and Charges (G.S. 105-228.5, G.S. 58-6-25)

Tax rates and charges for insurers taxed under G.S. 105-228.5 are as follows:

Workers' Compensation	2.50%
Other taxable contracts	1.90%
Property coverage contracts	.74%**
Article 65 Corporations	1.90%
Health Maintenance Organizations	1.90%
Insurance Regulatory Charge (2015 - 2016)	6.50%*

*Subject to change each year and is established by the General Assembly based on a proposed percentage rate submitted by the NC Department of Insurance sufficient to defray the estimated cost of the operations of the NC Department of Insurance for each upcoming fiscal year. This rate also applies to tax years 2016 and 2017.

**The additional tax on property coverage contracts is imposed on ten percent (10%) of the gross premiums from policies providing coverage for automobile physical damage and one hundred percent (100%) of the gross premium from all other property coverage contracts including policies providing coverage for wind damage (see G.S. 105-228.5(d)(3) for definitions).

H. Tax Rates and Charges for Captive Insurance Companies (G.S. 105-228.4A)

Tax rates for captive insurance companies taxed under G.S. 105-228.4A are as follows:

Direct Premiums	
Up to $20,000,000	0.400%
$20,000,000 and more	0.300%
Assumed Reinsurance Premiums	
Up to $20,000,000	0.225%
$20,000,000 to $40,000,000	0.150%
$40,000,000 to $60,000,000	0.050%
$60,000,000 and over	0.025%

The minimum tax is $5,000 and the maximum is $100,000 for captives filing as stand-alone captives unless the captive is a protected cell captive insurance company with more than 10 cells. The minimum and maximum tax amounts for a protected cell captive with more than 10 cells are $10,000 and $200,000, respectively.

The minimum tax is $5,000 and the maximum is $100,000 for a group of captive insurance companies under common ownership and control as determined by the North Carolina Department of Insurance filing as a single captive **unless** the group includes one or more special purpose financial captive insurance companies. If the consolidated group includes one or more special purpose captive insurance companies, the minimum is $5,000 for the group and the maximum is $200,000 since the maximum is $100,000 for the members of the group that are special purpose captives and $100,000 for the members that are not special purpose financial captives.

I. Retaliatory Provisions (G.S. 105-228.8)

When the laws of any other state impose, or would impose, any premium taxes, upon North Carolina companies doing business in the other state that are, on an aggregate basis, in excess of the premium taxes directly imposed upon similar companies by the statutes of this State, the Secretary of Revenue shall impose the same premium taxes, on an aggregate basis, upon the companies chartered in the other state doing business or seeking to do business in North Carolina. Retaliatory tax is reported and paid with the annual Gross Premium Tax return. Special purpose obligations or assessments based on premiums imposed in connection with particular kinds of insurance, the special purpose regulatory charge and dedicated special purpose taxes based on premiums are excluded from retaliatory computations. The additional tax on property coverage contracts is considered a special purpose assessment based on premiums and is not subject to retaliation. Captive insurance companies taxed under G.S. 105-228.4A are not subject to retaliatory tax.

If an insurer changes its state of domicile during the calendar year, the retaliatory tax must be calculated taking into account the portion of the year the company was domiciled in each state, respectively. For example, Company B is chartered in State A from January 1 through July 31, but changes its state of domicile to State B, effective August 1. The retaliatory calculation should reflect the taxes and includable fees and assessments charged by State A for business done for the period January 1 through July 31 and the taxes and includable fees and assessments charged by State B for business done for the period August 1 through December 31. Appropriate documentation supporting the retaliatory calculation must be attached to the gross premium tax return for the calendar year.

J. Installment Payments (G.S. 105-228.5(f))

Insurers, Article 65 corporations, health maintenance organizations, and self-insurers that have a premium tax liability, not including the additional local fire and lightning tax, of ten thousand dollars ($10,000) or more for business done in North Carolina during the immediately preceding year must remit three equal installments with each installment equal to at least thirty-three and one-third percent (33 1/3%) of the premium tax liability incurred in the immediately preceding taxable year. The due dates are April 15, June 15, and October 15 of each year.

Any insurer, corporation, self-insurer, or organization required to make premium tax installments, must also make installment payments of the Insurance Regulatory Charge. The same percentage and due date guidelines applicable to estimated installment payments of premium tax must be used in calculating and paying the insurance regulatory charge. Captive insurance companies are not required to make installment payments of tax due.

The balance of premium tax and insurance regulatory charge due is remitted by the following March 15 along with the annual tax return. The Secretary may permit an insurance company to pay less than the required installment amount when the insurer reasonably believes that the total estimated payments made for the current year will exceed the total anticipated tax liability for the year. An underpayment of an installment payment shall bear interest.

K. Due Dates (G.S. 105-228.5(e))

Annual returns along with payment of tax are due on or before March 15 of each year. Installment returns (if required) along with payment of tax are due on or before April 15, June 15, and October 15 of each year.

L. Electronic Funds Transfer (EFT) Requirement (G.S. 105-241, 105-236(lb))

Insurance companies paying premium tax of $240,000 or more in a fiscal year are required to remit this tax by EFT beginning with payments made in the following calendar year. Insurance companies will be notified by the Department if required to make EFT payments. Payments received in the wrong form are subject to a penalty equal to five percent (5%) of the tax. For additional information on EFT, refer to the subject, "Payments of Tax by EFT" under "General Administration." Insurers with premium tax liabilities less than $240,000 may choose to pay the tax electronically using ACH Debit or ACH Credit electronic funds transfer after receiving approval from the Department. For additional information, contact the Insurance Premium Tax Unit. Electronic filing of returns is not available.

M. Exempt Insurance Companies (G.S. 105-228.5(g))

The insurance premium tax requirements in G.S. 105-228.5 do not apply to farmers' mutual assessment fire insurance companies, to fraternal orders or societies that do not operate for a profit and do not issue policies on any person except members, or to captive insurance companies taxed under G.S. 105-228.4A.

N. Tax Credits (G.S. 105-228.5A, G.S. 97-29.1, Article 3A, Article 3H, and Article 3J of Chapter 105)

1. Guaranty Assessment Credits

North Carolina Guaranty Association assessments paid by insurers may be used as a credit against premium tax. The credit is twenty percent (20%) per year for a period of five years beginning with the year after payment of the assessment. The credit applies to all Insurance Guaranty Association and Life and Accident and Health Insurance Guaranty Association assessments paid. The credit may not exceed the premium tax liability for the year. Self-Insured Guaranty Association assessments paid may be applied as a hundred percent (100%) credit for the year in which it is paid.

2. Supplemental Workers' Compensation Credits

Supplemental workers' compensation benefits paid to NC residents may be applied as a credit.

3. Tax Credit for Low-income Housing

Effective for taxable years beginning on or after January 1, 2001, for buildings placed in service on or after that date, the tax credit for low-income housing may be taken against gross premium tax. See G.S. 105-129.40 – G.S. 105-129.45 for information about this credit. This credit is repealed effective January 1, 2015.

4. Tax Credit for Mill Rehabilitation

The tax credit for mill rehabilitation may be taken against gross premium tax. See G.S. 105-129.70 – G.S. 105-129.75A for information on this credit. This credit expires January 1, 2015, for rehabilitation projects for which an application for an eligibility certification is submitted on or after that date.

5. Tax Credit for Growing Businesses

The tax credits for growing businesses may be taken against gross premium tax. See G.S. 105-129.80 – G.S. 105-129.89 for information on the credits. The credits are repealed effective for business activities that occur on or after January 1, 2014.

6. Tax Credit for Investing in Renewable Energy Property

The tax credit for investing in renewable energy property may be taken against gross premium tax. See G.S. 105-129.16A for information on this credit. This credit is repealed effective for renewable energy property placed into service on or after January 1, 2016.

O. Insurance Tax Administered by Department of Insurance (G.S. 105-228.9)

Surplus lines tax, tax on risk retention groups not chartered in the State, and tax on persons procuring insurance directly with an unlicensed insurer are administered by the North Carolina Department of Insurance. Licensing and filing fees of insurers are also administered by the Department of Insurance along with the financial reporting requirements for the insurers.

P. No Additional Local Taxes (G.S. 105-228.10)

No county, city, or town shall be allowed to impose any additional tax, license, or fee, other than ad valorem taxes, upon any insurance company or association paying the fees and taxes levied under the insurance premium tax statutes.

Q. Exemption From Franchise or Corporate Income Tax (G.S. 105-228.5(a), 105-130.11(a)(10))

An insurer taxed under G.S. 105-228.5, Article 65 corporation, or health maintenance organization that is subject to the insurance gross premium tax in this State is not required to file or pay franchise or corporate income tax. A captive insurance company that is paying insurance premium tax levied under G.S. 105-228.4A is not required to file or pay franchise or corporate income tax.

R. Penalties

If an insurer fails to file any return by the date it is due, the Secretary must assess a penalty equal to five percent (5%) of the tax if the failure is for not more than one month, with an additional five percent (5%) for each additional month, or fraction thereof, during which the failure continues. The maximum penalty is twenty-five percent (25%) in the aggregate.

If an insurer fails to pay any tax when due, without intent to evade the tax, the Secretary must assess a penalty equal to ten percent (10%) of the tax.

If an insurer knowingly and willfully fails to comply with any of the provisions in the General Statutes or the Administrative Code, the Secretary must assess a penalty equal to ten percent

(10%) of the deficiency that is a result of the insurer’s negligence.

IV. TAX CREDITS
(Articles 3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H, 3J, 3K, 3L and 4)

A. Overview

Many of the tax credits available to corporations are repealed or designated for sunset. Please refer to each specific Article for details.

Effect on Installments and Carryforwards – A taxpayer that qualified for a tax credit that has expired or sunset may continue to take any remaining installments or carryovers in the current tax year if the taxpayer continues to meet the statutory eligibility requirements previously required of each particular tax credit.

B. Tax Credits (Article 4)

1. General Information

Most of the general tax credits previously available to taxpayers under Article 4 of the General Statutes have been repealed or have expired for tax years beginning 1/1/2014 and beyond.

The tax credits allowed under Article 4 of Chapter 105 must be taken against corporate income tax. Please refer to each specific credit for details.

a. Forms

Form CD-425 is used to report credits that are not limited to fifty percent (50%) of the tax. The Form NC-478 series is used to calculate and report tax credits that are limited to fifty percent (50%) of the tax, less the sum of all other credits that the taxpayer claims. Forms NC-478A through NC-478L are used to calculate the specific credits without regard to the fifty percent (50%) limitation. Form NC-478 is used to total the specific credits, to determine if the fifty percent (50%) limitation applies, and allocate the limited total credit among the specific credits.

Form CD-425 and, if applicable, Form NC-478 and the corresponding Form NC-478 series form must be filed for any taxable year in which the taxpayer is eligible to claim a credit, take a credit, or take an installment of a credit against the taxpayer's tax liability for that year. This requirement applies even if the taxpayer's tax liability for that year is not large enough for the taxpayer to benefit from the credit. Form CD-425 and Form NC-478 series forms are available from the Department's web site at:

http://www.dor.state.nc.us/downloads/corporate.html

2. Credit for Dwelling Units for Handicapped Persons (G.S. § 105-130.22)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

Corporate owners of multifamily rental units located in North Carolina are allowed an income tax credit for each dwelling unit for physically handicapped persons constructed during the income year, subject to the limitations set out below.

The allowable credit is five hundred fifty dollars ($550) for each dwelling unit that qualifies for use by physically handicapped persons. However, credit is allowed only for the number of such dwelling units completed during the income year that were constructed and required to be built in compliance with Volume I-C of the North Carolina Building Code.

No adjustment is required to be made to the depreciable cost of the unit on account of the allowable credit.

b. Carryforward

If the allowable income tax credit exceeds the taxpayer's income tax liability reduced by all other credits allowed against North Carolina income tax, the excess may be carried forward and claimed by such taxpayer in the next succeeding year only.

c. Eligibility

To qualify for the credit, the units must meet the requirements of Volume I-C of the North Carolina Building Code. Volume I-C is administered by the Building Accessibility Section of the North Carolina Department of Insurance and contains provisions and standards for making buildings and facilities accessible to and usable by physically handicapped persons. This section applies to all buildings and facilities regulated by the North Carolina State Building Code, with the exception of single and two-family dwellings.

d. Substantiation

The corporation must include with the tax return a copy of the occupancy permit on which the building inspector must record the number of qualified units completed during the income year.

3. Credit for Construction of Cogenerating Power Plant (G.S. § 105-130.25)

a. Credit

A corporation or partnership, other than a public utility as defined in G.S. § 62-3(23), that constructs a cogenerating power plant is allowed a credit for a portion of the cost to purchase and install the electrical or mechanical power generation equipment of that plant. To be eligible for the credit, the corporation or partnership must own or control the power plant at the time of construction.

The allowable credit is equal to ten percent (10%) of the cost paid during the tax year in which the credit is claimed for the purchase and installation of the electrical or mechanical power generation equipment of a cogenerating power plant. The credit may not be taken for the year in which the costs are paid but shall be taken for the taxable year beginning during the calendar year following the calendar year in which the costs are paid.

b. Cogenerating Power Plant Defined

A cogenerating power plant is a power plant that sequentially produces electrical or mechanical power and useful thermal energy using natural gas as its primary energy source. A plant whose combustion equipment uses residual oil, middle distillate oil, gasoline, or liquid propane gas (LPG) as a primary fuel will not qualify for the credit.

c. Alternative Method

An eligible taxpayer may elect to treat the costs paid during an earlier year as if they were paid during the year the plant becomes operational. Once made, the election is irrevocable. An election with respect to costs paid by a partnership must be made by the partnership and is binding on any partners to whom the credit is passed through.

If a taxpayer makes this election, the credit may not exceed twenty-five percent (25%) of the amount of tax for the year reduced by the sum of all credits allowed, except payments of tax by or on behalf of the taxpayer. Any unused portion of the credit may be carried forward for the next ten (10) taxable years.

d. Application

An application is required to be filed with the Secretary on or before April 15 following the calendar year in which the costs were paid without regard to the method elected by the taxpayer. Under either method, the taxpayer applies for the total credit for the first year eligible.

e. Ceiling

The total amount of all tax credits allowed for payments for construction and installation made in a calendar year may not exceed five million dollars ($5,000,000). If the total amount of credits for eligible payments applied for by all taxpayers exceeds five million dollars ($5,000,000), in any one calendar year, the maximum allowable credit will be prorated among all applicants proportionally. If the taxpayer’s eligible credit is reduce because of the ceiling, the reduction may be carried forward for the next ten taxable years. The taxpayer must reapply each year for the unused credits.

4. Credit for Real Property Donated for Conservation Purposes (G.S. § 105-130.34)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

Any C corporation that makes a qualified donation of an interest in real property located in North Carolina during the taxable year is allowed a credit against its corporate income tax.

The credit is twenty-five percent (25%) of the fair market value of the property interest donated. The credit allowed for one or more qualified donations made in a taxable year may not to exceed five hundred thousand dollars ($500,000).

b. Eligible Property Interest

To be eligible for this credit the donated interest in real property must be useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, forestland or farmland conservation, watershed protection, conservation of natural areas, conservation of natural or scenic river areas, conservation of predominately natural parkland, or historic land conservation, and the interest in real property must be donated in perpetuity to and accepted by the State, a local government, or a body that is both organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions pursuant to G.S. § 105-130.9.

Lands required to be dedicated pursuant to local government regulation or ordinance and dedications made to increase building density levels permitted under a regulation or ordinance are not eligible for this credit.

c. Substantiation

The taxpayer must file with its income tax return for the taxable year in which the credit is claimed, a certification by the Department of Environment and Natural Resources that the property donated is suitable for one or more of the valid public benefits set forth in this subsection, and a self-contained appraisal report or summary appraisal report. For fee simple absolute donations of real property, the taxpayer may provide documentation of the county's appraised value of the property, as adjusted by the sales assessment ratio, in lieu of an appraisal report.

d. Carryforward

If the allowable income tax credit exceeds the taxpayer's tax liability reduced by all other credits allowed against North Carolina income tax, the excess may be carried forward and deducted in the next five succeeding years.

e. Limitations

The portion of the fair market value of the property used to calculate the allowable tax credit is not allowed as a charitable contribution deduction.

5. Credit for Conservation Tillage Equipment (G.S. § 105-130.36)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

A corporation that purchases conservation tillage equipment for use in a farming business, including tree farming, shall be allowed an income tax credit equal to twenty-five percent

(25%) of the cost of the equipment paid during the taxable year.

b. Conservation Tillage Equipment Defined

Conservation tillage equipment means planters such as those commonly known as “no-till” planters designed to minimize disturbance of the soil in planting crops or trees, including equipment that may be attached to equipment already owned by the taxpayer. The term also means equipment designed to minimize disturbance of the soil in reforestation site preparation. The inclusion of reforestation equipment that may be attached to equipment already owned by the taxpayer is limited to those items of equipment generally known as “KG-Blades”, “drum-choppers”, or “V-Blades”.

c. Cap on Credit

This credit may not exceed two thousand five hundred dollars ($2,500) for any taxable year of any taxpayer.

d. Restrictions

The credit may only be claimed by the first purchaser of the equipment and may not be claimed by a corporation that purchases the equipment for resale or for use outside this State.

e. Carryforward

If the credit exceeds the taxpayer’s income tax liability, the excess may be carried over and claimed in the next five (5) succeeding years.

f. Basis Reduction

The basis in any equipment for which a credit is allowed under this section shall be reduced by such credit.

6. Credit for Gleaned Crop (G.S. § 105-130.37)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

A corporation that grows a crop and permits the gleaning of the crop is allowed an income tax credit equal to ten percent (10%) of the market price of the quantity of the gleaned crop.

b. Definitions

i. Gleaning

The harvesting of a crop that has been donated by the grower to the nonprofit organization that will distribute the crop to individuals or other nonprofit organizations it considers appropriate recipients of the food.

ii. Market price

The season average price of the crop as determined by the North Carolina Crop and Livestock Reporting Service in the Department of Agriculture and Consumer Services, or the average price of the crop in the nearest local market for the month in which the crop is gleaned if the Crop and Livestock Reporting Service does not determine the season average price for that crop.

iii. Nonprofit organization

An organization to which charitable contributions are deductible under the Code.

c. Cap on Credit

The allowable credit cannot exceed the taxpayer's tax liability.

d. Carryforward

Any unused portion of the credit may be carried forward for the succeeding five (5) years.

e. Restrictions

A charitable contribution deduction is not allowed under G.S. § 105-130.5(b)(5) for any items for which this credit is claimed.

7. Credit for Certain Telephone Subscriber Line Charges (G.S. § 105-130.39)

a. Credit (Repealed effective for tax years beginning on or after January 1, 2014)

A corporation that provides local telephone services to low income residential customers at reduced rates is allowed a credit equal to the difference between the amount of receipts the corporation would have received from those low-income customers had the regular rates been charged and the amount billed to those low income customers.

b. Restrictions

The credit is allowed only for a reduction in local telephone service rates and fees. No credit is allowed for any reduction in interstate subscriber line charges.

c. Cap on Credit

The credit may not exceed the amount of corporate income tax for the taxable year reduced by the sum of all credits allowable, except tax payments made by or on behalf of the corporation.

8. Credit for Use of North Carolina Ports (G.S. § 105-130.41)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

An income tax credit is available to a corporation whose waterborne cargo is loaded onto or unloaded from an ocean carrier calling at the North Carolina ports of Wilmington or Morehead City. The credit is allowed against corporate income tax in an amount equal to the excess of the wharfage, handling (in or out) and throughput charges assessed on the cargo for the current taxable year over an amount equal to the average of the charges for the current taxable year and the two preceding taxable years. For purposes of this section, the terms "handling" (in and out) and "wharfage" have the meanings provided in the State Ports Tariff Publications, "Wilmington Tariff, Terminal Tariff #6," and "Morehead City Tariff, Terminal Tariff #1" and the term "throughput" has the same meaning as "wharfage" but applies only to bulk products, both dry and liquid.

b. Limitations and Carryforward

The amount of credit is limited to fifty percent (50%) of the income tax liability for the taxable year reduced by the sum of all credits allowable. Any unused portion of the credit may be carried forward and applied to the income tax liability for the five succeeding years. The maximum cumulative credit that may be claimed by a corporation is two million dollars ($2,000,000).

c. Substantiation

To obtain the credit, the taxpayer must provide a statement from the State Ports Authority certifying the amount of charges paid on which the credit is based.

9. Credit for Supervisory Fees Paid by Savings and Loan Associations (G.S. § 105-130.43)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

Savings and loan associations are allowed an income tax credit equal to the amount of supervisory fees paid to the savings and loan division of the Department of Commerce.

b. Cap on Credit

The credit claimed may not exceed the amount of corporate income tax, reduced by the sum of all credits allowed against the tax, except tax payments made by or on behalf of the taxpayer.

c. Restrictions

These fees cannot be deducted in determining taxable income if they are claimed as an income tax credit.

10. Credit for Poultry Composting Facility (G.S. § 105-130.44)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

An income tax credit is available to corporations for constructing a poultry composting facility in North Carolina for the composting of poultry carcasses from commercial poultry operations. The credit is equal to twenty-five percent (25%) of the installation, materials and equipment costs of construction paid during the taxable year. The credit allowed does not apply to costs paid with funds provided by a State or federal agency.

b. Limitations and Carryforward

The credit may not exceed one thousand dollars ($1,000) for any single installation. The credit may not exceed the amount of tax for the taxable year reduced by the sum of all tax credits allowable, except payments of tax by or on behalf of the taxpayer. Any unused portions of the credit may not be carried forward.

11. Credit for Manufacturing Cigarettes for Exportation (G.S. § 105-130.45)

a. Credit (Repealed effective for cigarettes exported on or after 1/1/2018)

An income tax credit is allowed to a corporation engaged in the business of manufacturing cigarettes in the United States for exportation to a foreign country, a possession of the United States, and a commonwealth of the United States that is not a state. A corporation must waterborne export cigarettes and other tobacco products through the North Carolina State Ports during the taxable year to qualify for the credit. However, the calculation of the credit is not limited to just cigarettes that are waterborne exported. The amount of credit available is based on the current year's exportation volume compared to the base year's exportation volume. In the case of a successor in business, the amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporaton's predecessor corporations' combined base year exportation volume, rounded to the nearest whole percentage. The amount of credit may not exceed six million dollars ($6,000,000) and is computed as follows:

Current Yr.'s Exportation Volume Compared to its Base Yr.'s Exportation Volume	Amount of Credit per 1000 Cigarettes Exported
120% or more	40 cents
119% - 100%	35 cents
99% - 80%	30 cents
79% - 60%	25 cents
59% - 50%	20 cents
Less than 50%	None

b. Substantiation

A corporation that claims this credit must include these items with its tax return:

- A statement of the base year exportation volume. The base year is calendar year 2003.
- A statement of the exportation volume on which the credit is based.
- A list of the corporation's export volumes as shown on its monthly reports to the Alcohol and Tobacco Tax and Trade Bureau of the United States Treasury for the months in the tax year for which the credit is claimed.

c. Limitations and Carryforward

The maximum eligible credit for cigarettes exported during the taxable year is the lesser of six million dollars ($6,000,000) or fifty percent (50%) of the amount of income tax liability for the taxable year reduced by the sum of all other credits. Any unused credit for cigarettes exported may be carried forward for the next succeeding ten (10) years.

d. No Double Credit

A taxpayer may not claim this credit and the credit allowed under G.S. § 105-130.46 for the same activity.

e. Sunset

This credit is repealed effective for cigarettes exported on or after January 1, 2018.

12. Credit for Manufacturing Cigarettes for Exportation While Increasing Employment and Utilizing State Ports (G.S. § 105-130.46)

a. Credit (Expires for exports occurring on or after 1/1/2018)

A corporation engaged in the business of manufacturing cigarettes for exportation that satisfies the employment level requirement for this credit and exports cigarettes and other tobacco products through the North Carolina State Ports during the taxable year is allowed a credit for manufacturing cigarettes for exportation while increasing employment and utilizing State Ports. The amount of the credit is equal to forty cents (40¢) per one thousand cigarettes exported; however, the amount of credit earned during the taxable year may not exceed ten million dollars ($10,000,000).

b. Definitions

The following definitions apply:

i. Employment level
The total number of full-time jobs and part-time jobs converted into full-time equivalences.

ii. Exportation
The shipment of cigarettes manufactured in the United States to a foreign country sufficient to relieve the cigarettes in the shipment of the federal excise tax on cigarettes.

iii. Full-time job
A position that requires at least one thousand six hundred (1,600) hours of work per year and is intended to be held by one employee during the entire year.

iv. Successor in business
A corporation that through amalgamation, acquisition, consolidation, merger or other legal succession becomes invested with the rights and assumes the burdens of the predecessor corporation and continues the cigarette exportation business.

c. Employment Level

The corporation must maintain an employment level in this State that exceeds the corporation's employment level in the State at the end of the 2004 calendar year by at least eight hundred (800) full-time jobs. A job is located in this State if more than fifty percent (50%) of the employee's duties are performed in this State.

d. Reduction of Credit

A corporation that has previously satisfied the qualification requirements for this credit but that fails to satisfy the employment level requirement in a succeeding year may still claim a partial credit for the year in which the employment level requirement is not satisfied. The partial credit allowed is equal to the credit that would otherwise be allowed multiplied by a fraction. The numerator of the fraction is the excess of the number of full-time jobs in this State over the corporation's employment level in this State at the end of the 2004 calendar year. The denomination of the fraction is eight hundred (800). In the case of a successor business, the numerator of the fraction is the number of full-time jobs by which the corporation's employment level in this State exceeds all its predecessor corporations' combined employment levels in this State at the end of the 2004 calendar year.

e. Tax Election

The credit may be taken against either corporate income tax or franchise tax. When the taxpayer claims this credit, the taxpayer must elect the percentages of the credit claimed against corporate income tax and franchise tax, respectively. This election is binding for the year in which it is made and for any carryforwards. A taxpayer may elect a different allocation for each year in which the taxpayer qualifies for a credit.

f. Ceiling

The total amount of this credit calculated as described above may not exceed fifty percent (50%) of the tax against which the credit is taken reduced by the sum of all other credits allowed against that tax, except tax payments made by or on behalf of the taxpayer. This limitation applies to the cumulative amount of the credit allowed in any tax year, including carryforwards claimed for this credit or the credit allowed under G.S. § 105-130.45 for previous years.

g. Carryforward

Any unused portion of the credit may be carried forward for the next succeeding ten (10) years. All carryforwards must be taken against the tax against which the credit was originally claimed. A successor in business may take the carryforwards of a predecessor corporation as if they were carryforwards of a credit allowed to the successor in business.

h. Substantiation

A corporation that claims this credit must include these items with its tax return:

- A statement of the exportation volume on which the credit is based.
- A list of the corporation's export volumes shown on its monthly reports to the Alcohol and Tobacco Tax and Trade Bureau of the United States Treasury for the months in the tax year for which the credit is claimed.
- Any other information required by the Department of Revenue.

i. No Double Credit

A taxpayer may not claim this credit and the credit allowed under G.S. § 105-130.45 for the same activity.

j. Sunset

This credit expires for exports occurring on or after January 1, 2018.

13. Credit for Qualifying Expenses of a Production Company (G.S. § 105-130.47)

a. Credit (Repealed for qualifying expenses occurring on or after 1/1/2015)

A taxpayer that is a production company and has qualifying expenses of at least two hundred fifty thousand dollars ($250,000) with respect to a production is allowed a credit against corporate income taxes. The credit is equal to fifteen percent (15%) of the production company's qualifying expenses. The credit is claimed for the taxable year in which the production activities are completed but includes all of the taxpayer's qualifying expenses incurred with respect to the production, including qualifying expenses incurred in earlier years. In the case of an episodic television series, an entire season of episodes is one production.

b. Definitions

i. Qualifying Expenses

The sum of the total amount spent in this State for the following by a production company in connection with a production, less the amount in excess of one million dollars ($1,000,000) paid to a highly compensated individual:

- Goods and services leased or purchased. For goods with a purchase price of twenty-five thousand dollars ($25,000) or more, the amount included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.
- Compensation and wages on which withholding payments are remitted to the Department of Revenue under Article 4A of this Chapter.
- The cost of production-related insurance coverage obtained on the production. Expenses for insurance coverage purchased from a related member are not qualifying expenses.

ii. Highly Compensated Individual

A highly compensated individual is one who receives compensation in excess of one million dollars ($1,000,000) with respect to a single production. If an individual receives compensation in excess of one million dollars ($1,000,000), only one million dollars ($1,000,000) of the compensation is included in the production's qualifying expenses. A highly compensated individual is an individual who receives compensation in excess of one million dollars ($1,000,000) for personal services with respect to a single production, regardless of whether the individual receives the compensation directly from the production company or indirectly from a personal service company or an employee leasing company and regardless of whether the compensation is considered wages or nonemployee compensation.

iii. Production Company (G.S. § 105-164.3)

A person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. However, radio productions do not qualify for the credit.

iv. Feature Film

A movie that is made for initial distribution in theaters and that is over forty (40) minutes long.

v. Live Sporting Event

A scheduled sporting competition, game, or race that is not originated by a production company, but is originated solely by an amateur, collegiate, or professional organization, institution, or association for live or tape-delayed television or satellite broadcast. A live sporting event does not include commercial advertising, an episodic television series, a television pilot, a music video, a motion picture, or a documentary production where any sporting events are presented through archived historical footage or similar footage taken at least thirty (30) days before it is used.

vi. Related Member

A person that, with respect to the taxpayer during any part of the taxable year, is one or more of the following:

- A related entity.
- A component member.
- A person to or from whom there would be attribution of stock ownership in accordance with section 1563(e) of the Code if the phrase "5 percent (5%) or more" were replaced by "twenty percent (20%) or more" each place it appears in that section.

c. Qualifying Expenses for Compensation and Wages

Compensation and wages paid to employees for services performed in North Carolina on which income tax withholding payments are remitted to the Department of Revenue are eligible for the tax credit regardless of whether paid to residents or non-residents. Payments for per diem, living allowances, and fringe benefits are eligible to the extent they are included in the recipient's taxable wages subject to federal income tax withholding. The amount paid to an individual through a personal services corporation or through an employee-leasing organization is considered compensation and is subject to the "highly compensated individual" limitations in calculating the allowable credit.

d. Qualifying Expenses for Services

Spending for services is eligible for the tax credit regardless of whether paid to residents or non-residents, as long as the services are performed in North Carolina. The amount paid to an individual through a personal services corporation or through an employee leasing organization is subject to the "highly compensated individual" limitation in calculating the allowable credit.

e. Qualifying Expenses for Goods

Spending for goods purchased or leased from a North Carolina business is eligible for the tax credit. This includes fuel, food, airline tickets and other goods if purchased or leased from a business located in North Carolina.

f. Pass-through Entity

Notwithstanding the provisions of G.S. § 105-131.8 and G.S. § 105-269.15, a pass-through entity that qualifies for this credit does not allocate the credit among any of its owners. Instead, the pass-through entity is considered the taxpayer for purposes of claiming this credit. If a return filed by a pass-through entity indicates that the entity is paying tax on behalf of the owners of the entity, the credit allowed under this section does not affect the entity's payment of tax on behalf of its owners and cannot be applied against that liability.

g. Return

The credit is claimed on Form NC-415 filed for the taxable year in which the production activities are completed. Processing of the credit cannot begin until after the income tax return for the taxable year in which the production activities are completed is filed. The taxpayer must satisfy any tax liability for the tax year in which the tax credit is claimed before the credit will be refunded.

h. Credit Refundable

If the credit allowed exceeds the amount of income tax for the taxable year reduced by the sum of all credits allowable, the excess is refundable to the taxpayer. The refundable excess is governed by the same provisions that govern the refund of an income tax overpayment by the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits.

i. Limitations

The amount of credit allowed under this section with respect to a production that is a feature film may not exceed seven million five hundred thousand dollars ($7,500,000). There is no maximum credit for other types of productions. No credit is allowed under this section for any production that satisfies one of the following conditions:

- It is political advertising.
- It is a television production of a news program or live sporting event.
- It contains material that is obscene, as defined in G.S. § 14-190.1.
- It is a radio production.

j. Substantiation

A taxpayer allowed a credit under this section must maintain and make available for inspection any information or records required by the Secretary of Revenue. The taxpayer has the burden of proving eligibility for a credit and the amount of the credit. The Secretary may consult with the North Carolina Film Office of the Department of Commerce and the regional film commissions in order to determine the amount of qualifying expenses. To claim a credit under this section, a taxpayer must first notify the Division of Tourism, Film and Sports Development in the Department of Commerce of the taxpayer’s intent to claim the production tax credit. The notification must include the title of the production, the name of the production company, a financial contact for the production company, the proposed dates on which the production company plans to begin filming the production, and any other information required by the Division. For productions that have production credits, a taxpayer claiming a credit under this section must acknowledge in the production credits both the North Carolina Film Office and the regional film office responsible for the geographic area in which the filming of the production occurred.

k. Sunset

This credit is repealed for qualifying expenses occurring on or after January 1, 2015.

8. Credit for Recycling Oyster Shells (G.S. § 105-130.48)

a. Credit (Repealed for tax years beginning on or after 1/1/2014)

A taxpayer who donates oyster shells to the Division of Marine Fisheries of the Department of Environment and Natural Resources is eligible for a credit against corporate income tax. The credit is one dollar ($1.00) per bushel of oyster shells donated.

b. Limitation

The credit allowed cannot exceed the amount of corporate income tax for the taxable year reduced by the sum of all credits allowable, except corporate income tax payments made by or on behalf of the taxpayer.

c. Carryforward

Any unused portion of this credit may be carried forward for the succeeding five years. A successor in business may take the carryforwards of a predecessor corporation as if they were carryforwards of a credit allowed to the successor in business.

d. No Double Benefit

A taxpayer that claims this credit may not take a deduction for a contribution allowed under G.S. § 105-130.5(b)(5) or G.S. § 105-130.9.

e. Substantiation

A taxpayer that claims this credit must obtain and maintain with its records a certification by the Department of Environment and Natural Resources stating the number of bushels of oyster shells donated by the taxpayer.

f. Sunset

This credit is repealed for taxable years beginning on or after January 1, 2014.

C. Tax Incentives for New and Expanding Businesses (Article 3A)

For most taxpayers, Article 3A credits expired for activities incurred prior to January 1, 2007. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable Form NC-478, available at the Department's website at:

http://www.dor.state.nc.us/downloads/corporate.html

D. Business & Energy Tax Credits (Article 3B)

1. General Information (*Applies to all credits under this article unless otherwise noted.)*

a. Franchise, Income, or Gross Premium Tax Election (G.S. § 105-129.17(a))

The credits allowed under Article 3B can be taken against franchise or income tax, but not against insurance gross premium tax unless otherwise noted. The taxpayer must elect the tax against which a credit will be claimed when filing the return on which the first installment of the credit is claimed. This election is binding. All future installments and carryforwards of a credit must be claimed against the same tax.

b. Cap on Credit (G.S. § 105-129.17(b))

Total credits, including carryforwards, claimed under Article 3B may not exceed fifty percent (50%) of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits, including carryforwards, against that tax, except tax payments made by or on behalf of the taxpayer.

c. Credit Carryforward (G.S. § 105-129.17(b))

Unused portions of the credits may be carried forward for the succeeding five (5) years unless otherwise noted, but must be taken against the same tax as on the return on which the credit was first taken.

d. Substantiation (G.S. § 105-125.18)

The burden of proving eligibility for any credit under this article rests upon the taxpayer. Every taxpayer claiming a credit under this article must maintain and make available for inspection by the Secretary of Revenue any records the Secretary considers necessary to determine and verify the amount of the credit to which the taxpayer is entitled. No credit may be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

2. Credit for Investing in Renewable Energy Property (G.S. § 105-129.16A)

a. Credit (Repealed effective for renewable energy property placed into service on or after January 1, 2016)

A taxpayer that has constructed, purchased, or leased renewable energy property is allowed a credit equal to thirty-five (35%) of the cost of the property if the property is placed into service during the taxable year. No credit is allowed to the extent the cost of the renewable energy property was provided by public funds.

If the taxpayer owns the property, the cost is determined in accordance with section 1012 of the Code and is subject to the limitation on cost provided in section 179 of the Code. If the property is leased, the cost is eight (8) times the net annual rental rate. The net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The sub-rentals are not deducted if they are business income for the taxpayer.

If the property serves a single-family dwelling, the credit is taken for the taxable year in which the property is placed in service. For all other property, the credit is taken in five (5) equal installments beginning with the year the property is placed in service.

This credit can be taken against franchise tax, income tax, or against insurance gross premium tax. For more information on this credit, refer to the "2014 Guidelines for Determining the Tax Credit for Investing in Renewable Energy Property" available from the Department's website at:

http://www.dor.state.nc.us/taxes/corporate/renewable_energy_credits.pdf

b. Cap on Credit (G.S. § 105-129.16A(c))

The maximum credit allowed for nonresidential property is two million five hundred thousand dollars ($2,500,000) per installation. The credit ceilings for residential property are:

- One thousand four hundred dollars ($1,400) per dwelling unit for solar energy equipment for domestic water heating, including a system that heats a pool.
- Three thousand five hundred dollars ($3,500) per dwelling for solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating; and
- Ten thousand five hundred dollars ($10,500) per installation for any other renewable energy property for residential purposes.

c. Eligible Renewal Energy Property (G.S. § 105-129.15)

Any of the following machinery and equipment or real property is considered to be eligible renewable energy property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; commercial thermal or electrical generation. Effective for taxable years beginning on or after January 1, 2006 electrical generation is no longer restricted to using renewable energy crops or wood waste material. Biomass equipment includes any equipment used for converting, conditioning and storing the liquid fuels, gas and electricity produced with biomass equipment.
- Hydroelectric generators located at existing dams or waterways and related devices

for water supply and control and converting, conditioning, and storing the electricity generated.

- Solar energy equipment that uses solar radiation as a substitute for traditional energy for water heating, active space heating and cooling, passive heating, daylighting, generating electricity, distillation, desalination, detoxification, or the production of industrial or commercial process heat. Solar energy equipment includes any equipment used for collecting, storing, exchanging, conditioning, or converting solar energy to other useful forms of energy.
- Wind equipment required to capture and convert wind energy into electricity or mechanical power and related devices.

d. Expiration of Credit (G.S. § 105-129.16A(b))

If the property is disposed of, taken out of service, or moved out of North Carolina during the five year installment period, the credit expires and a taxpayer may not take any remaining installment of the credit except for the portion of an installment that accrued in a previous year and has been carried forward. No credit is allowed to the extent the cost of the renewable energy property was provided by public funds.

e. Credit Availability (G.S. § 105-129.16A(d))

A taxpayer may not claim a credit for renewable energy property under Article 3B if the taxpayer is claiming any other credit allowed in Chapter 105 with respect to renewable energy property. A taxpayer may not take a credit for property the taxpayer leases from another unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to the property.

f. Delayed Sunset

Taxpayers meeting certain production capacity and project completion requirements were eligible for extension of the credit sunset until January 1, 2017 if they filed an application with the Department of Revenue by October 1, 2015 asserting that the extension criteria would be met, and paid an applicable fee. Taxpayers, along with a licensed engineer and certified public accountant also were required to provide documentation by March 1, 2016 certifying the percentage completion and cost requirements were met with respect to the renewable energy project.

3. Credit for Constructing Renewable Fuel Facilities (G.S. § 105-129.16D)

a. Credit (Except as provided in G.S. § 105-129.16D(b), repealed effective for facilities placed in service on or after January 1, 2014)

Either a dispensing credit or a production credit is allowed for the construction of renewable fuel facilities. Either credit is subject to the tax election and cap on credit amount provisions of G.S. § 105-129.17, the substantiation requirements of G.S. § 105-129.18, and the requirement in G.S. § 105-129.19 that the Department report the credits claimed to the

Revenue Laws Study Committee and to the Fiscal Research Division of the General Assembly.

b. Renewable Fuel Defined (G.S. 105-129.15(8))

Renewable fuel is either:

- Biodiesel as defined in G.S. § 105-449.60
- Ethanol either unmixed or in mixtures with gasoline that are seventy percent (70%) or more ethanol by volume.

c. Dispensing Credit (G.S. § 105-129.16D(a))

A taxpayer that constructs and installs and places in service in this State a qualified facility for dispensing renewable fuel is allowed a dispensing credit. A facility is qualified if the equipment used to store or dispense renewable fuel is labeled for this purpose and is clearly identified as associated with renewable fuel.

The credit is equal to fifteen percent (15%) of the cost to the taxpayer of constructing and installing the part of the dispensing facility, including pumps, storage tanks, and related equipment, that is directly and exclusively used for dispensing or storing renewable fuel.

The tax credit is claimed in three equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the portion of a facility that is directly and exclusively used for dispensing or storing renewable fuel is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim any carryforwards of any prior years' installments.

d. Production Credit (G.S. § 105-129.16D(b))

A taxpayer that constructs and places in service in this State a commercial facility for processing renewable fuel is allowed a production credit. The credit is equal to twenty-five percent (25%) of the cost to the taxpayer of constructing and equipping the facility. The tax credit is claimed in seven equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the facility is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim carryforwards of any prior years' installments.

e. Alternative Production Credit (G.S. § 105-129.16D(b1))

A taxpayer that constructs and places in service in this State three or more commercial facilities for processing renewable fuel and invests a total amount of at least four hundred million dollars ($400,000,000) in the facilities is allowed a credit equal to thirty-five percent (35%) of the cost of constructing and equipping the facilities in lieu of the production credit allowed in G.S. § 105-129.16D(b). To claim the credit, the taxpayer must obtain a written determination from the Secretary of Commerce that the taxpayer is expected to invest, within a five-year period, a total amount of at least four hundred million dollars ($400,000,000) in three or more facilities.

The credit is taken in seven equal annual installments beginning with the taxable year in which the first facility is placed in service. If, in any one of the years in which an installment of the credit is to be claimed, a facility with respect to which the credit is claimed is disposed of or taken out of service and the investment requirements are no longer satisfied, the credit expires and the taxpayer may take any remaining installment of the credit only to the extent allowed under G.S. § 105-129.16D(b). The taxpayer may, however, take the portion of an installment of the alternative production credit that accrued in a previous year and was carried forward to the extent permitted under G.S. § 105-129.17.

Notwithstanding the provisions of G.S. § 105-129.17(a), a taxpayer may claim the alternative production credit against corporate income tax only.

f. No Double Credit (G.S. § 105-129.16D(c))

A taxpayer cannot claim the credits allowed under G.S. § 105-129.16D(b) and G.S. § 105-129.16D(b1) with respect to the same facility. A taxpayer that claims any other tax credit allowed under Chapter 105 with respect to the costs of constructing and installing a renewable energy facility may not take the credits allowed in this section with respect to the same costs.

4. Credit for Biodiesel Producers (G.S. § 105-129.16F) (Repealed for tax years beginning on or after January 1, 2014)

Effective for taxable years beginning on or after January 1, 2008, biodiesel providers that produce at least one hundred thousand (100,000) gallons of biodiesel during the taxable year are allowed a credit equal to the per gallon excise tax the producer paid under Article 36C of Chapter 105. For purposes of this credit, "biodiesel" is defined as "liquid fuel derived in whole from agricultural products, animal fats, or wastes from agricultural products or animal fats."

The credit does not apply to tax paid on diesel fuel included in a biodiesel blend. The maximum annual credit is five hundred thousand dollars ($500,000).

5. Work Opportunity Tax Credit (G.S. § 105-129.16G) (Expired for taxable years beginning on or after January 1, 2014)

A taxpayer who is allowed a federal work opportunity tax credit under Part IV, Subpart F of the Code is allowed to take a credit against its North Carolina corporate income or franchise tax equal to six percent (6%) of the credit allowed under the Code for wages paid during the taxable year for positions located in this State. A position is located in this State if more than fifty percent (50%) of the employee's duties are performed in this State. This section expires for taxable years beginning on or after January 1, 2012.

6. Credit for Donations to a Nonprofit Organization or Unit of State or Local Government for Acquisition of Renewable Energy Property (G.S. § 105-129.16H) (Repealed for renewable energy property placed into service on or after January 1, 2016)

Effective for taxable years beginning on or after January 1, 2008, a taxpayer who donates money to a tax-exempt nonprofit organization or a unit of State or local government for the purpose of providing funds for the organization or government unit to construct, purchase, or lease renewable energy property is allowed a credit under this section if the donation is used for its intended purpose. The amount of the credit is equal to the taxpayer's proportionate share of the credit the nonprofit organization or government unit could have taken under G.S. § 105-129.16A if the nonprofit organization or government unit were subject to tax. The credit must be taken in the taxable year the property is placed in service. The installment requirement for nonresidential property in G.S. § 105-129.16A does not apply. The nonprofit organization or government unit must provide each taxpayer who made a donation a statement describing the property, setting out the cost of the property, the amount of the credit the organization or government unit could claim if it were subject to tax, and the taxpayer's share of the credit. A taxpayer claiming a credit under this section may not deduct this donation as a charitable contribution.

E. Tax Incentives for Recycling Facilities (Article 3C)

1. General Information

a. Qualifications

A recycling facility qualifies for the tax credits provided in this Article and Article 5 for major recycling facilities if:

- The facility is located in an area that was an enterprise tier one area at the time the owner began construction of the facility.
- The Secretary of Commerce has certified that the owner will, by the end of the fourth year after the year the owner begins construction of the recycling facility, invest at least three hundred million dollars ($300,000,000) in the facility and create at least two hundred fifty (250) new, full-time jobs at the facility.

b. Forfeiture (G.S. § 105-129.26(c))

If the owner of major recycling facility fails to make the required minimum investment or create the required number of new jobs within the period certified by the Secretary of Commerce, the recycling facility no longer qualifies for the recycling tax benefits provided in Article 3C and Article 5 and forfeits all tax credits previously received under this Article and in Article 5. Forfeiture does not occur; however, if the failure was due to events beyond the owner's control.

Upon forfeiture, the owner is liable for a tax equal to the amount of all past taxes avoided as a result of the tax credits claimed plus interest at the rate established in G. S. § 105-241.21, computed from the date the taxes would have been due if the tax benefits had not been received. The tax and interest are due thirty (30) days after the date of the forfeiture. An owner that fails to pay the tax and interest is subject to the penalties provided in G.S. § 105-236.

c. Substantiation (G.S. § 105-129.26(d))

The burden of proving eligibility for the credit under this Article rests upon the taxpayer. Every taxpayer claiming a credit under this Article must maintain and make available for inspection by the Secretary of Revenue any records the Secretary considers necessary to determine and verify the amount of the credit to which the taxpayer is entitled. No credit may be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

d. Forms

Form CD-425 is used to report the tax credit claimed under this Article. This form must be filed for any taxable year in which a credit or a carryforward of a credit against the taxpayer's tax liability for that year is claimed.

2. Credit for Investing in Major Recycling Facility (G.S. § 105-129.27)

a. Credit

An owner that purchases or leases machinery and equipment for a major recycling facility in this State during the taxable year is allowed a credit equal to fifty percent (50%) of the amount payable by the owner during the taxable year to purchase or lease the machinery and equipment.

b. Taxes Credited (G.S. § 105-129.27(b))

The credit provided in this section is allowed against franchise and income tax. Any other nonrefundable credits allowed the owner are subtracted before the credit allowed by this section. The taxpayer must elect the tax against which a credit will be claimed when filing the return on which the credit is first claimed. All carryforwards of a credit must be claimed against the same tax.

c. Credit Carryforward (G.S. § 105-129.27(c))

The credit may not exceed the amount of tax against which it is claimed for the taxable year, reduced by the sum of all other credits allowed against that tax, except tax payments made by or on behalf of the owner. Any unused portion of the credit may be carried forward for the succeeding twenty-five (25) years.

d. Change in Ownership of Facility (G.S. § 105-129.27(d))

The sale, merger, consolidation, conversion, acquisition, or bankruptcy of a recycling facility, or any transaction by which the facility is reformulated as another business, does not create new eligibility in a succeeding owner with respect to a credit for which the predecessor was not eligible under this section. A successor business may, however, take any carried-over portion of a credit that its predecessor could have taken if it had a tax liability.

e. Forfeiture (G.S § 105-129.27(e))

If any machinery or equipment for which a credit was allowed under this section is not placed in service within thirty (30) months after the credit was allowed, the credit is forfeited. A taxpayer that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. § 105-241.21, computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the penalties provided in G.S. § 105-236.

f. Limitations (G.S. § 105-129.27(f))

A recycling facility that is eligible for the credit allowed in this section is not allowed the credit for investing in machinery and equipment provided in G.S. § 105-129.9 or G.S. § 105-129.88.

F. Historic Rehabilitation Tax Credits (Article 3D)

1. General Information (This Article expired for qualified expenditures incurred on or after January 1, 2015 and was replaced with new historic rehabilitation credit in Article 3L discussed in subsection G.)

a. Tax Credited (G.S. § 105-129.37(a))

The credits provided in this Article are allowed only against income tax.

b. Credit Limitations (G.S. § 105-129.37(b))

A credit allowed may not exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

A credit must be taken in five equal installments beginning with the taxable year in which the property is placed in service. Any unused portion of a credit may be carried forward for the succeeding five years.

c. Forms

Form CD-425 is used to report any tax credits claimed under this article. This form must be filed for any taxable year in which a credit or an installment of a credit against the taxpayer's tax liability for that year is claimed.

2. Credit for Rehabilitating Income-Producing Historic Structure (G.S. § 105-129.35)

a. Credit (G.S. § 105-129.35(a))

A taxpayer that is allowed a federal income tax credit under section 47 of the Code for making qualified rehabilitation expenditures for a certified historic structure located in North Carolina is allowed a State income tax credit equal to twenty percent (20%) of the expenditures that qualify for the federal credit. The tax credit is forty percent (40%) of qualifying expenditures if the certified historic structure is a facility that at one time served as a State training school for juvenile offenders.

b. Allocation (G.S. § 105-129.35(b) and (c))

Notwithstanding the provisions of G.S. § 105-131.8 and G.S. § 105-269.15, a pass-through entity that qualifies for the credit may allocate the credit among any of its owners at its discretion as long as an owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the certified historic structure is placed in service, is at least forty percent (40%) of the amount of credit allocated to that owner. Owners to whom a credit is allocated are allowed the credit as if they had qualified for the credit directly. A pass-through entity and its owners must include a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. § 105-131.8 or G.S. § 105-269.15 with their tax returns for every taxable year in which an allocated credit is claimed. A pass-through entity includes a Subchapter S corporation, a limited liability company, a limited partnership, a general partnership and a joint venture. An owner of a pass-through entity is an individual or entity who is treated as an owner under the federal tax laws.

c. Forfeiture for Disposition (G.S. § 105-129.37(c))

A taxpayer who is required under section 50 of the Code to recapture all or part of the federal credit for rehabilitating an income-producing historic structure located in this State forfeits the corresponding part of the State credit allowed with respect to that historic structure. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allowed.

d. Forfeiture for Change in Ownership (G.S. § 105-129.37(d))

If an owner of a pass-through entity that has qualified for the credit allowed disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the rehabilitated historic structure is placed in service and the owner's interest is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the historic structure was placed in service, the owner forfeits a portion of the credit. The amount forfeited is determined by multiplying the amount of credit by the percentage reduction in ownership and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code. The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

e. Exceptions to Forfeiture (G.S. § 105-129.37(e))

Forfeiture for change in ownership is not required if the change in ownership is the result of any of the following:

- The death of the owner.
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

f. Liability from Forfeiture (G.S. § 105-129.37(f))

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. § 105-241.21, computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the taxes and interest by the due date is subject to penalties as provided in G.S. § 105-236.

g. Substantiation (G.S. § 105-129.35(a))

A taxpayer claiming this credit must attach to the return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has been properly rehabilitated.

3. Credit for Rehabilitating Non-income-Producing Historic Structure (G.S. § 105-129.36)

a. Credit (G.S. § 105-129.36(a))

A taxpayer that is not allowed a federal income tax credit under section 47 of the Code and who incurs rehabilitation expenses for a non-income producing State-certified historic structure is allowed a credit against North Carolina income tax.

The amount of the credit is thirty percent (30%) of the rehabilitation expenses taken in five equal installments beginning with the taxable year in which the property is placed in service. The tax credit is forty percent (40%) of qualifying expenditures if the certified historic structure is a facility that at one time served as a State training school for juvenile offenders.

Rehabilitation expenses do not include the cost of acquiring the property, site work, personal property or cost attributable to the enlargement of the existing property.

b. Eligibility (G.S. § 105-129.36(a))

To qualify for the credit, the taxpayer's rehabilitation expenses must exceed twenty-five thousand dollars ($25,000) within a twenty-four-month period.

c. Substantiation (G.S. § 105-129.36(a))

To claim the credit, a taxpayer must attach to the return a copy of the certification issued by the State Historic Preservation Officer.

G. Historic Rehabilitation Tax Credits (Article 3L)

1. General Information (This Article replaces Article 3D credits and is effective for qualified expenditures incurred on or after January 1, 2016)

a. Tax Credited (G.S. § 105-129.108(a))

The credits provided in this Article are allowed against franchise tax, income tax, or gross premiums tax. The taxpayer must elect the tax against which the credit will be claimed when filing the return filing is made. Any future carryfowards of unused credits must be claimed against the same tax.

b. General Credit Limitations (G.S. § 105-129.108(c))

A credit allowed may not exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer. A taxpayer claiming a credit under Article 3L may not also claim a credit under Article 3D or 3H with respect to the same activity.

Any unused portion of a credit may be carried forward for the succeeding nine (9) years.

c. Forms (G.S. § 105-129.108(b))

Form CD-425 is used to report any tax credits claimed under this article. This form must be filed for any taxable year in which a credit or a carryover of a credit against the taxpayer's tax liability for that year is claimed. When an income-producing property is placed into service in two or more phases in different tax years, the amount of credit is based on the expenditure amount associated with the phase placed into service during the respective tax year.

d. Rules and Fees (G.S. § 105-129.107)

The North Carolina Historical Commission, in consultation with the State Historic

Preservation Officer, may adopt rules to administer Article 3L and a schedule of fees, not to exceed 1% of the completed qualifying rehabilitation expenditures.

e. Sunset (G.S. § 105-129.110)

Article 3L expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2020.

2. Credit for Rehabilitating Income-Producing Historic Structure (G.S. § 105-129.105)

a. Credit (G.S. § 105-129.105(a))

A taxpayer that is allowed a federal income tax credit under section 47 of the Code for making qualified rehabilitation expenditures for a certified historic structure located in North Carolina is allowed a State income tax credit equal to the sum of the following:

i. Base amount – 15% of qualified rehabilitation expenses up to 10 million dollars, plus 10% of qualified rehabilitation expenses in excess of 10 million dollars up to 20 million dollars.

ii. Development tier bonus – An amount equal to 5% of qualified rehabilitation expenses not exceeding 20 million dollars if the certified historic structure is located in a tier one or tier two area, as defined in G.S. § 143B-437.08.

iii. Targeted investment bonus – An amount equal to 5% of qualified rehabilitation expenses not exceeding 20 million dollars if the certified historic structure is located in North Carolina and meets all the following criteria:

(A) It was used as a manufacturing facility or for purposes ancillary to manufacturing, a warehouse for selling agricultural products, or as a public or private utility;

(B) It is a certified historic structure; and

(C) It has been at least 65% vacant for a period of at least two year immediately preceding the date the eligibility certification was made.

For purposes of the credit, the terms “qualified rehabilitation expenditures” and “certified historic structure” have the same meaning as under section 47 of the Code, and an “eligibility certification” is certification obtained from the State Historic Preservation Officer, defined in G.S. § 105-129.105(c)(7).

b. Credit Limitation (G.S. § 105-129.105(d))

The total amount of credit allowed for qualified rehabilitation expenditures for an income-producing certified historic structure may not exceed 4.5 million dollars.

c. Allocation from Pass-Through Entity (G.S. § 105-129.105(b))

Notwithstanding the provisions of G.S. § 105-131.8 and G.S. § 105-269.15, a pass-through entity that qualifies for the credit may allocate the credit among any of its owners at its discretion as long as an owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the certified historic structure is placed in service, is at least forty percent (40%) of the amount of credit allocated to that owner. Owners to whom a credit is allocated are allowed the credit as if they had qualified for the credit directly. A pass-through entity and its owners must include a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. § 105-131.8 or G.S. § 105-269.15 with their tax returns for every taxable year in which an allocated credit is claimed. A pass-through entity is defined in G.S. § 105-228.90.

d. Forfeiture for Disposition (G.S. § 105-129.108(d))

A taxpayer who is required under section 50 of the Code to recapture all or part of the federal credit for rehabilitating an income-producing historic structure located in this State forfeits the corresponding part of the State credit allowed with respect to that historic structure. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allowed.

e. Forfeiture for Change in Ownership (G.S. § 105-129.108(e))

If an owner of a pass-through entity that has qualified for the credit allowed disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the rehabilitated historic structure is placed in service and the owner's interest is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the historic structure was placed in service, the owner forfeits a portion of the credit. The amount forfeited is determined by multiplying the amount of credit by the percentage reduction in ownership and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code.

f. Exceptions to Forfeiture (G.S. § 105-129.108(f))

Forfeiture for change in ownership is not required if the change in ownership is the result of any of the following:

- The death of the owner.
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

g. Liability from Forfeiture (G.S. § 105-129.108(g))

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. § 105-241.21, computed from the date the taxes would have been due if the credit were not allowed. The past taxes plus interest are due 30 days from the date the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the taxes and interest by the due date is subject to the penalties provided in G.S. § 105-236.

h. Substantiation (G.S. § 105-129.108(h))

A taxpayer claiming this credit must provide any information required by the Secretary, including filing with the tax return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has met the rehabilitation requirements of Article 3L, and a copy of the eligibility certification if the historic structure is located in an eligible targeted investment site and the targeted investment bonus is claimed. A taxpayer must also maintain and make available for inspection by the Secretary all records necessary to determine and verify the amount of credit claimed.

3. Credit for Rehabilitating Non-income-Producing Historic Structure (G.S. § 105-129.106)

a. Credit (G.S. § 105-129.106(a))

A taxpayer that is not allowed a federal income tax credit under section 47 of the Code and who incurs rehabilitation expenses of at least 10 thousand dollars for a non-income producing State-certified historic structure is allowed a credit equal to 15% of the rehabilitation expenses.

"Rehabilitation expenses" are expenses incurred in the certified rehabilitation of a certified historic structure added to the property's basis and incurred without a 24 month period on a discrete property parcel. The term does not include the costs of acquiring the property, site work, personal property, or amounts attributable to enlargement of an existing building.

A "State-certified historic structure" is one that is individually listed in the National Register of Historic Places or is certified by the State Historic Preservation Officer, as defined in G.S. § 105-129.105(c)(7), as contributing to the historic significance of a National Register Historic District or locally district certified by the U.S. Department of the Interior.

b. Limitations (G.S. § 105-106(b))

The amount of credit allowed for rehabilitation expenses for a non-income producing historic structure may not exceed $22,500 per discrete property parcel, as defined in G.S. § 105-129.106(c)(2). A taxpayer that is the transferee of a State-certified historic structure with rehabilitation expenses is only allowed a credit if the transfer occurs before the structure is placed in service. In such a case, the transferee is the only taxpayer that may claim the credit. The date a property is placed in service is the later of the date on which the rehabilitation is completed or the date in which the property is used for its intended purpose.

A taxpayer can only claim a credit once during any five year period, not including carryovers.

c. Substantiation (G.S. § 105-129.108(h))

A taxpayer claiming this credit must provide any information required by the Secretary, including filing with the tax return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has met the rehabilitation requirements of Article 3L. A taxpayer must maintain and make available for inspection by the Secretary all records necessary to determine and verify the amount of credit claimed.

H. Low-Income Housing Tax Credits (Article 3E) (This Article is repealed effective January 1, 2015 for developments to which credits are allocated on or after January 1, 2015)

1. Credit for Low-income Housing Awarded a Federal Credit Allocation before January 1, 2003 (G.S. § 105-129.41)

a. Credit (G.S. § 105-129.41(a))

A taxpayer is allowed a tax credit for low-income housing for North Carolina tax purposes equal to a percentage of the total federal income tax credit allowed for the taxable year under section 42 of the Code with respect to a qualified North Carolina low-income building.

b. Computation of Credit (G.S. § 105-129.41(a))

The amount of the credit is equal to seventy-five percent (75%) of the total federal credit if the building is located in a tier one or tier two area. For buildings in other tier designations, the credit is equal to twenty-five percent (25%) of the total federal credit.

The total federal credit is the total allowed during the ten-year federal credit period plus the disallowed first year credit allowed in the 11th year. The total federal credit is calculated based on the qualified basis as of the end of the first year of the credit period and is not recalculated to reflect subsequent increases in the basis.

c. Franchise, Income, or Gross Premiums Tax Election (G.S. § 105-129.41(a1))

A taxpayer may claim a credit for low-income housing against franchise, income or insurance gross premiums tax. A taxpayer must elect the tax against which a credit will be claimed when filing the return on which the first installment of the credit is claimed. The election is binding. Any carryforwards of a credit must be claimed against the same tax.

d. Cap on Credit and Carryforward Provisions (G.S. § 105-129.41(a2))

Total credits claimed under Article 3E may not exceed fifty percent (50%) of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits, including carryforwards, against that tax, except tax payments made by or on behalf of the taxpayer.

Unused portions of the credits may be carried forward for the succeeding five years unless otherwise noted, but must be taken against the same tax as on the return on which the credit was first taken.

e. Timing of Credit (G.S. § 105-129.41(b))

The credit is taken in five equal installments beginning in the first taxable year in which the federal credit is taken. The amount of the installment for the first year must be multiplied by the applicable fraction under section 42(f)(2)(A) of the Code. Any reduction in the amount of the first installment as a result of this multiplication is carried forward and may be taken in the first taxable year after the fifth installment is allowed.

f. Allocation (G.S. § 105-129.41(b1))

Notwithstanding the provisions of G.S. § 105-131.8 and G.S. § 105-269.15, a pass-through entity that qualifies for the credit provided in this section may allocate the credit among any of its owners at its discretion as long as the owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the federal credit is first claimed is at least forty percent (40%) of the amount of credit allocated to that owner. Owners to whom a credit is allocated are allowed the credit as if they had qualified for the credit directly. A pass-through entity and its owners must include, with their tax returns for every taxable year in which an allocated credit is claimed, a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. § 105-131.8 or G.S. § 105-269.15.

g. Qualified Building (G.S. § 105-129.41(c)(1), (2) and (3))

For purposes of the credit, a building is a "qualified North Carolina low-income building" if it was allocated a federal income tax credit under section 42(h)(1) of the Internal Revenue Code, and meets any of the following conditions:

- It is located, at the time the federal credit is allocated to the building, in a tier one or tier two area.
- It is located, at the time the federal credit is allocated to the building, in a tier three or tier four area and forty percent (40%) of its residential units are both rent-restricted and occupied by individuals whose income is fifty percent (50%) or less of the area median gross income.
- It is located, at the time the federal credit is allocated to the building, in a tier five area and forty percent (40%) of its residential units are both rent-restricted and occupied by individuals whose income is thirty-five percent (35%) or less of area median gross income.

h. Expiration (G.S. § 105-129.41(d))

If, in one of the five years in which an installment of the credit accrues, the taxpayer becomes ineligible for the federal credit, then the credit expires and the taxpayer may not take any remaining installments of the credit. However, the taxpayer may take the portion of an installment that accrued in a previous year and was carried forward.

i. Forfeiture for Disposition (G.S. § 105-129.41(e))

If the taxpayer is required, under section 42(j) of the Code, to recapture all or part of the federal credit claimed, the taxpayer must report the recapture event to the Secretary and to the Housing Finance Agency and forfeits the corresponding part of the credit allowed for North Carolina purposes. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allocated. The taxpayer forfeits all or part of the State credit only if the event resulting in federal recapture occurs during the period of time during which the State credit is taken, which is either five or six years. The federal credit is taken over a period of ten or eleven years.

j. Forfeiture for Change in Ownership (G.S. § 105-129.41(f))

If an owner of a pass-through entity that has qualified for the credit allowed under this section disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the federal credit is first claimed and the owner's interest in the pass-through entity is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the federal credit is first claimed, the owner must report the change in its percentage ownership to the Secretary and to the Housing Finance Agency and forfeits all or a portion of the State credit.

The amount forfeited is determined by multiplying the amount of the credit by the percentage reduction in ownership, and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code. The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

Forfeiture as provided in this section is not required if the change in ownership is the result of any of the following:

- The death of the owner.
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

k. Liability from Forfeiture (G.S. § 105-129.41(g))

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. 105-241.21 computed from the date the taxes would have been due if the credit had not been allowed. The due date for past taxes and interest is thirty days after the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the past taxes and interest by the due date is subject to the penalties provided in G.S. § 105-236.

2. Credit for Low-income Housing Awarded a Federal Credit Allocation on or after January 1, 2003 (G.S. § 105-129.42) (This Article is repealed Effective January 1, 2015, see G.S. § 105.129.45)

a. Credit (G.S. § 105-129.42(b))

A taxpayer who is allocated a federal income tax credit under section 42 of the Code to construct or substantially rehabilitate a qualified North Carolina low-income housing development is allowed a credit equal to a percentage of the development's qualified basis, as determined pursuant to section 42(d) of the Code. For the purpose of this section, qualified basis is calculated based on the information contained in the carryover allocation and is not recalculated to reflect subsequent increases or decreases. No credit is allowed for a development that uses tax-exempt bond financing.

b. Definitions (G.S. § 105-129.42(a))

These definitions apply:

i. Qualified Allocation Plan

The plan governing the allocation of federal low-income housing tax credits for a particular year, as approved by the Governor after a public hearing and publication in the North Carolina Register.

ii. Qualified North Carolina low-income housing development

A qualified low-income project or building that is allocated a federal tax credit under section 42(h)(1) of the Code and is described in below.

iii. Qualified Residential Unit

A housing unit that meets the requirements of section 42 of the Code.

c. Developments and Amounts (G.S. § 105-129.42(c))

The housing developments that are qualified North Carolina low-income housing developments and the percentage of the development's eligible basis for which a credit is allowed are:

- If forty percent (40%) of the qualified residential units are affordable to households whose income is fifty percent (50%) or less of area median income and the units are in a Low-Income county or city, the percentage of the basis for which a credit is allowed is thirty percent (30%).

- If fifty percent (50%) of the qualified residential units are affordable to households whose income is fifty percent (50%) or less of the area median income and the units are in a Moderate-Income county or city, the percentage of the basis for which a credit is allowed is twenty percent (20%).

- If fifty percent (50%) of the qualified residential units are affordable to households whose income is forty percent (40%) or less of the area median income and ten percent (10%) of the units are in a High-Income county or city, the percentage of the basis for which a credit is allowed is ten percent (10%).

- If twenty-five percent (25%) of the qualified residential units are affordable to households whose income is thirty percent (30%) or less of the area median income and ten percent (10%) of the units are in a High-Income county or city, the percentage of the basis for which a credit is allowed is ten percent (10%).

The designation of a county or city as Low Income, Moderate Income, or High Income and determinations of affordability are made by the Housing Finance Agency in accordance with the Qualified Allocation Plan in effect as of the time the federal credit is allocated. A change in the income designation of a county or city after a federal credit is allocated does not affect the percentage of the developer's eligible basis for which the credit is allowed. The affordability requirements apply for the duration of the federal tax credit compliance period.

d. Election of Method for Receiving Tax Credit (G.S. § 105-129.42(d))

When a taxpayer to whom a federal low-income housing credit is allocated submits a request to receive a carryover allocation for that credit to the Housing Finance Agency, the taxpayer must elect to receive the tax credit in the form of either a direct tax refund or a loan generated by transferring the credit to the Housing Finance Agency. Neither a direct tax refund nor a loan received as the result of the transfer of the credit is considered taxable income.

e. Exception When No Carryover (G.S. § 105-129.42(e))

If a taxpayer does not submit a request to receive a carryover allocation to the Housing Finance Agency, the taxpayer must elect the method for receiving the credit allowed when the taxpayer files federal Form 8609 with the Agency. The credit is claimed for the taxable year in which the federal Form 8609 is filed.

f. Pass-Through Entity (G.S. § 105-129.42(f))

Notwithstanding the provisions of G.S. § 105-131.8 and G.S. § 105-269.15, a pass-through entity that qualifies for the credit does not distribute the credit among any of its owners. The pass-through entity is considered the taxpayer for purposes of claiming the credit. If a return filed by a pass-through entity indicates that the entity is paying tax on behalf of the owners of the entity, the credit allowed does not affect the entity's payment of tax on behalf of its owners.

g. Return and Payment (G.S. § 105-129.42(g))

A taxpayer may claim the credit allowed on a return filed for the taxable year in which the taxpayer receives a carryover allocation of a federal low-income housing credit. The return must state the name and location of the qualified low-income housing development for which the credit is claimed.

If a taxpayer chooses the loan method for receiving the credit, the Secretary must transfer the amount of credit allowed the taxpayer to the Housing Finance Agency. The Agency must loan the taxpayer the amount of the credit on terms consistent with the Qualified Allocation Plan. The Housing Finance Agency is not required to make a loan to a qualified North Carolina low-income housing development until the Secretary transfers the credit amount to the Agency.

If the taxpayer chooses the direct tax refund method for receiving the credit allowed, the Secretary must transfer the refundable excess of the credit allowed the taxpayer to the Housing Finance Agency. The Agency holds the refund due the taxpayer in escrow, with no interest accruing to the taxpayer during the escrow period. The Agency must release the refund to the taxpayer upon the occurrence of the earlier of the following:

- The time the Agency determines that the taxpayer has complied with the Qualified Allocation Plan and has completed at least fifty percent (50%) of the eligible activities included in the development's eligible base.
- Within thirty (30) days after the development is placed in service date.

h. Forfeiture (G.S. § 105-129.42(c) and (h))

The credit is forfeited if, in any tax year, the taxpayer fails to meet the affordability requirements, as determined by the Housing Finance Agency.

A taxpayer that receives a credit under this section must immediately report any recapture event under section 42 of the Code to the Housing Finance Agency. If the taxpayer or any of its owners are required, under section 42(j) of the Code, to recapture all or part of a federal credit with respect to a qualified North Carolina low-income development, the taxpayer forfeits the corresponding part of the credit allowed under this section. This requirement does not apply in the following circumstances:

- When the recapture of part or all of the federal credit is the result of an event that occurs in the sixth or subsequent calendar year after the calendar year in which the development was awarded a federal credit allocation.
- The taxpayer elected to transfer the credit allowed to the Housing Finance Agency.

i. Liability from Forfeiture (G.S. § 105-129.42(i))

A taxpayer that forfeits all or part of the credit allowed is liable for all past taxes avoided and any refund claimed as a result of the credit plus interest at the rate established under G.S. § 105-241.21. The interest rate is computed from the date the Secretary transferred the credit amount to the Housing Finance Agency. The past taxes, refund and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer that fails to pay the taxes, refund, and interest by the due date is subject to the penalties provided in G.S. § 105-236.

3. Substantiation (G.S. § 105-129.43)

A taxpayer allowed a credit under Article 3E must maintain and make available for inspection any information or record required by the Secretary or the Housing Finance Agency. The burden of proving eligibility for a credit and the amount of the credit rests upon the taxpayer.

I. Research and Development Tax Credit (Article 3F) (This Article expires for taxable years beginning on or after January 1, 2016)

1. General Information

a. Administration (G.S. § 105-129.51)

Any taxpayer, regardless of its type of business, is allowed a tax credit for qualified North Carolina research expenses, if the taxpayer meets the eligibility requirements relating to wage standard, health insurance, environmental impact, and safety and health programs found in G.S. § 105-129.83(c), (d), (e) and (f).

b. Tax election (G.S. § 105-129.52)

A taxpayer may claim the credit allowed in Article 3F against either franchise or income tax. The taxpayer must elect the tax against which the credit will be claimed when filing the return on which the credit is first claimed. The election is binding and applies to both the credit and any carryforwards of the credit.

c. Cap (G.S. § 105-129.52)

The credit allowed in Article 3F cannot exceed fifty percent (50%) of the amount of tax against which it is claimed, reduced by the sum of all other tax credits allowed against that tax. This limitation applies to the cumulative amount of credit, including carryforwards. Any unused portion of this credit may be carried forward for the succeeding fifteen (15) taxable years.

d. Substantiation (G.S. § 105-129.53)

Each taxpayer that claims a credit under Article 3F must maintain and make available for inspection any information or records required by the Secretary. The burden of proof for a credit and the amount of the credit rests upon the taxpayer.

e. Forms

The Form NC-478 series is used to calculate and report tax credits, including the Article 3F credits, that are limited to fifty percent (50%) of the taxpayer's tax less the sum of all other credits that the taxpayer claims. Form NC-478I is used to calculate the research and development tax credits without regard to the fifty percent (50%) limitation. Form NC-478 is used to total the specific credits, to determine if the fifty percent (50%) applies, and, if so, to allocate the limited total credit among the specific credits.

2. Definitions (G.S. § 105-129.50)

The definitions in section 41 of the Code apply in this Article. Additionally, the following definitions apply also:

a. North Carolina university research expenses

Any amount the taxpayer paid or incurred to a research university for qualified research performed in this State or basic research performed in this State.

b. Period of measurement

Defined in the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13 CFR 121.104), the period of measurement is used to determine the entity's annual receipts and is determined by how long an entity has been in business.

If the entity has been in business for less than three years, the annual receipts for the period of measurement are the receipts for the period of time for which the entity has been in business divided by the number of weeks in business and multiplied by fifty-two (52).

If the entity has been in business for three full fiscal years and has not filed a short-period income tax return for any of those three years, the annual receipts for the period of measurement are the total receipts over the last three years divided by three.

If one of the three years' returns is a short-period return, the annual receipts for the period of measurement are the receipts for the short year and the two full years divided by the total number of weeks in the short year and two full years divided by fifty-two (52).

c. Qualified North Carolina research expenses

Qualified research expenses, other than North Carolina university research expenses, for research performed in this State.

d. Receipts

Defined in the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13 CFR 121.104), receipts means total income, gross income plus cost of goods sold as reported for federal income tax purposes, less net capital gains or losses and taxes collected for and remitted to a taxing authority to the extent included in gross or total income, proceeds from transactions between the entity and its domestic or foreign affiliates if also excluded from gross or total income on a federal consolidated return, and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

e. Related person

Defined in G.S. § 105-163.010 and IRC sections 267(b) or 707(b).

f. Research university

An institution of higher education that meets one of the following conditions:

(a) Is classified in the most recent edition of 'A Classification of Institutions of Higher Education', the official report of The Carnegie Foundation for the Advancement of Teaching as one of the following:

- Doctoral/Research Universities, Extensive or Intensive.
- Masters Colleges and Universities, I or II.
- Baccalaureate Colleges, Liberal Arts or General.

(b) Is a constituent institution of The University of North Carolina.

g. Small business

A business whose annual receipts, combined with the annual receipts of all related persons, for the applicable period of measurement did not exceed one million dollars ($1,000,000).

3. Credit for North Carolina Research and Development (G.S. § 105-129.55)

The credit is equal to a percentage of the expenses based on whether the expenses qualify as small business, low tier research, university research, eco-industrial park, or other research expenses. Only one credit is allowed with respect to the same expenses. If the expenses qualify in more than one category, then the credit is equal to the higher percentage, not both percentages combined. If part of the taxpayer's expenses qualifies under more than one subdivision, the applicable percentages apply separately to each part of the expenses.

For North Carolina university research expenses, the applicable percentage is twenty percent (20%). For expenses with respect to research performed in an eco-industrial park certified under G.S. § 143B-437.08, the applicable percentage is thirty-five percent (35%).

If the taxpayer was a small business as of the last day of the taxable year, the applicable percentage is three and twenty-five hundredths percent (3.25%). Research performed in a development tier one area is considered low-tier research and the applicable percentage is three and twenty-five hundredths percent (3.25%). Research expenses that do not qualify as small business or low-tier are considered other research.

If other research expenses are greater than zero but not greater than fifty million dollars ($50,000,000), the applicable percentage is one and twenty-five hundredths percent (1.25%). If other research expenses are greater than fifty million dollars ($50,000,000), but not greater than two hundred million dollars ($200,000,000), the applicable percentage is two and twenty-five hundredths percent (2.25%). If other research expenses are greater than two hundred million dollars ($200,000,000), the applicable percentage is 3.25%.

J. Credit for Mill Rehabilitation (Article 3H) (This Article expires January 1, 2015 for rehabilitation projects for which an application is submitted on or after such date. Eligibility certifications for this Article expire January 1, 2023)

1. General Information (G.S. § 105-129.73(a))

A taxpayer that places eligible rehabilitated mill property into service is allowed a credit against either franchise tax, corporate income tax, or gross premiums tax. The taxpayer must elect the tax against which the credit is being claimed when filing the return on which the credit is claimed. The election is binding and any installments or carryforwards of the credit must be claimed against the same tax.

a. Cap on credit (G.S. § 105-129.73(b))

The credit cannot exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by or on behalf of the taxpayer. Any unused credit may be carried forward for the succeeding nine years.

b. Coordination with Article 3D (G.S. § 105-129.74)

A taxpayer claiming a credit under this Article cannot also claim a credit under Article 3D with respect to the same activity. The authority given to the North Carolina Historical Commission in Article 3D to establish rules and fees also applies to this Article.

2. Credit for income-producing rehabilitated mill property (G.S. § 105-129.71)

a. Credit

A taxpayer that is allowed a federal income tax credit under Code section 47 for making qualified rehabilitation expenditures of at least three million dollars ($3,000,000) with respect to a certified rehabilitation of an eligible site is allowed a State credit equal to a percentage of the expenditures that qualify for the federal credit. The credit may be claimed in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenditures associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is:

- Forty percent (40%) of the qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of the eligibility certification.
- Thirty percent (30%) of the qualified expenditures if the eligible site is located in a tier four or five area on the date of the eligibility certification.

b. Allocation

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least forty percent (40%) of the amount of credit allocated to that owner. This differs from the allocation principles in G.S. § 105-131.8 and G.S. § 105-269.15 that apply to all other tax credits.

Under the general allocations provisions in G.S. § 105-131.8 and G.S. § 105-269.15, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership must have a substantial economic effect, which means that the allocation agreement must reflect the economic interests of the partners in the partnership and cannot be based solely on tax consequences.

A statement of the allocation made under the special provision for this credit and the allocation that would have been required if this provision were not law must be included with the tax returns filed by the pass-through entity and the owners for each year in which the allocated credit is claimed.

c. Forfeiture for change in ownership

The owner of a pass-through entity must forfeit a portion of the credit for rehabilitating income-producing mill property if the owner disposes of more than one-third of the owner's interest in the pass-through entity within five years from the date the eligible site is placed in service. The forfeiture amount is determined by multiplying the amount of the credit by the percentage reduction in ownership and then multiplying that product by the federal recapture percentage found in Code section 50(a)(1)(B).

d. Exceptions to forfeiture

Forfeiture is not required if the change in ownership is the result of:

- The death of the owner, or

- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

e. Liability from forfeiture

An owner of a pass-through entity that forfeits a credit for change in ownership is liable for all past taxes avoided as the result of claiming the credit, plus interest at the rate established under G.S. § 105-241.21 computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty days after the date the credit is forfeited. If the taxes and interest are not paid by the due date, the taxpayer is subject to the penalties in G.S. § 105-236.

3. Credit for nonincome-producing rehabilitated mill property (G.S. § 105-129.72)

a. Credit

A taxpayer that is not allowed a federal income tax credit under Code section 47 and that makes qualified rehabilitation expenses of at least three million dollars ($3,000,000) with respect to a certified rehabilitation of an eligible site is allowed a State tax credit equal to a percentage of the rehabilitation expenses. The credit may be claimed in five equal installments beginning in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenses associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is forty percent (40%) of qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of the eligibility certification. No credit is allowed if the eligible site is in a tier four or five area.

b. Allocation

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least forty percent (40%) of the amount of credit allocated to that owner. This differs from the allocation principles in G.S. § 105-131.8 and G.S. § 105-269.15 that apply to all other tax credits. Under the general allocation provisions, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership must have a substantial economic effect, which means that the allocation agreement must reflect the economic interests of the partners in the partnership and cannot be based solely on tax consequences. A statement of the allocation made under the special provision for this credit and the allocation that would have been required if this provision were not law must be included with the tax returns filed by the pass-through entity and the owners for each year in which the allocated credit is claimed.

c. Forfeiture for change in ownership

If an owner of a pass-through entity disposes of more than one-third of the owner's interest in the pass-through entity within five years from the date the eligible site is placed in service, the owner must forfeit a portion of the credit for rehabilitating nonincome-producing mill property. The forfeiture amount is determined by multiplying the amount of the credit by the percentage reduction in ownership and then multiplying that product by the federal recapture percentage found in Code section 50(a)(1)(B). The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

d. Exceptions to forfeiture

Forfeiture is not required if the change in ownership is the result of:

- The death of the owner, or
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

e. Liability from forfeiture

An owner of a pass-through entity that forfeits a credit for change in ownership is liable for all past taxes avoided as the result of claiming the credit, plus interest at the rate established under G.S. § 105-241.21 computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. If the taxes and interest are not paid by the due date, the taxpayer is subject to the penalties provided in G.S. § 105-236.

K. Tax Credits for Growing Businesses (Article 3J) (This Article is repealed effective for business activities that occur on or after January 1, 2014).

Guidelines for these credits are available by clicking on the following:

http://www.dor.state.nc.us/taxes/corporate/article3j.pdf.

L. Tax Incentive for Railroad Intermodal Facility (Article 3K) (This Article is repealed for tax years beginning on or after January 1, 2038)

1. Credit (G.S. § 105-129.96)

A taxpayer that constructs or leases an eligible railroad intermodal facility in this State and places it in service during the tax year is allowed a tax credit equal to fifty percent (50%) of amounts paid by the taxpayer towards the cost of construction or under the lease. The credit may not exceed fifty percent (50%) of the tax against which it is claimed. Any unused portion of a credit may be carried forward for ten years.

2. Taxes Credited (G.S. § 105-129.96)

The credit is allowed against either income or franchise tax. The taxpayer must elect the tax against which the credit is claimed when filing the return on which the credit is first claimed. This election is binding. Any carryforwards of the credit must be taken against the same tax.

3. Definitions (G.S. § 105-129.95)

a. Costs of Construction

The costs of acquiring and improving land, constructing buildings and other structures, equipping the facility, and constructing and equipping rail tracks to the railroad intermodal facility that are necessary to access and support facility operations. In the case of property owned or leased by the taxpayer, cost is determined pursuant to regulations adopted under section 1012 of the Code.

b. Eligible railroad intermodal facility

A railroad intermodal facility for which the costs of construction exceed thirty million dollars ($30,000,000).

c. Intermodal facility

A facility where freight is transferred from one mode of transportation to another.

d. Railroad intermodal facility

An intermodal facility whose primary purpose is to transfer freight between a railroad and another mode of transportation.

4. Substantiation (G.S. § 105-129.97)

Any taxpayer claiming this credit must maintain adequate records to determine and verify the amount of the credit and must make these records available for inspection by the Secretary. The burden of proving eligibility and the amount of the credit rests upon the taxpayer. No credit will be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

5. Reports (G.S. § 105-129.98)

The Department must publish a report showing the number of taxpayers claiming this credit, the amount of the credit claimed and the tax against which the credit is claimed, and the total cost to the General Fund no later than May 1 of each year.

6. Sunset (G.S. § 105-129.99)

This Article is repealed effective for taxable years beginning on or after January 1, 2038.