



# **PERSONAL TAXES BULLETIN**

**Individual Income Tax  
Pass-Through Entities  
Withholding Tax**

**Reflecting Changes Made in the 2020 Regular Session  
of the North Carolina General Assembly**

**Personal Taxes Division  
December 2020**

## PREFACE

The Personal Taxes Bulletin was prepared for the purpose of presenting the administrative interpretation and application of North Carolina income tax laws relating to individuals, partnerships, S corporations, estates, trusts, and income tax withholding in effect at the time of publication. This publication supplements the information 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administrative rule, or case law subsequent to the date of this publication, the provisions in this bulletin may be superseded or voided.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 **2020 Regular Session** of the North Carolina General Assembly.

In general, the Personal Taxes Bulletin addresses the tax law applicable to filing an individual income tax return or an income tax return for a pass-through entity for tax year 2020 and income tax withholding responsibilities during tax year 2021.

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# I. COVID-19 Provisions

## 1. Introduction

Because of the COVID-19 pandemic, federal and state governments offered administrative and statutory tax relief to taxpayers. This section provides a summary of North Carolina tax relief available to individuals, pass-through entities, and employers:

- [State Tax Relief for Individuals, Partnerships, and Estates & Trusts](#)
- [State Tax Relief for Employers](#)
- [Extension of Certain Appeal Deadlines](#)

[Session Law 2020-58](#) updated North Carolina's reference to the Internal Revenue Code to May 1, 2020, which included federal tax provisions enacted in the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). However, North Carolina specifically [decoupled from several provisions of the CARES Act](#).

Finally, [Session Law 2020-97](#), the Coronavirus Relief Act 3.0, included the [Extra Credit Grant Program](#), which was administered by the Department.

## 2. State Tax Relief for Individuals, Partnerships, and Estates & Trusts

### a. Automatic Extension of Time to File

In March 2020, the Department [automatically extended the time](#) to file North Carolina individual income, partnership, and estate and trust tax returns due on April 15, 2020, to July 15, 2020. In addition, the Department announced it would not charge certain penalties (e.g., failure to file, failure to pay, failure to file an informational return) for those taxpayers whose tax returns and tax payments were due on April 15, 2020, as long as the return was filed and the tax was paid on or before July 15, 2020.

### b. Waiver of Interest

Pursuant to [Session Law 2020-3](#), the Department did not charge interest on an underpayment of tax due on a franchise, corporate income, or individual income tax return, including a partnership tax return and an estate and trust tax return, (collectively "Affected Tax Returns") due to be filed between April 15, 2020, and July 15, 2020 (collectively, the "COVID Period"). As enacted, interest did not accrue (accumulate) on an underpayment of tax during the COVID Period. Importantly, interest began to accrue on underpayments of tax beginning July 16, 2020.

Under [Session Law 2020-3](#), the relief from interest also applies to estimated tax payments due pursuant to [G.S. § 105-163.15](#). Accordingly, the Department will waive the accrual of interest, during the COVID Period, owed on estimated tax payments due during the COVID Period.

### c. Extension of the Statute of Limitations for Requesting a Refund

[Session Law 2020-3](#) extended the statute of limitations for obtaining a refund to July 15, 2020, for refund claims for which the statute of limitations to seek a refund expired on or after April 15, 2020, and before July 15, 2020 (collectively, the “COVID Period”).

**Example:** Taxpayer timely filed a 2016 North Carolina individual income tax return and paid the tax shown due in full on April 15, 2017. Taxpayer amended the 2016 tax return on July 2, 2020. Taxpayer requested a refund of an overpayment.

Under the general provisions of [G.S. § 105-241.6\(a\)](#), the statute of limitations for refunds expired on April 15, 2020. As such, Taxpayer would not be entitled to the requested refund. However, because Taxpayer requested a refund during the COVID Period, the statute of limitations for requesting a refund was extended to July 15, 2020.

For additional information, see [NCDOR Actions on COVID-19](#).

*Reference:* [Session Law 2020-3](#).

## 3. State Tax Relief for Employers

### a. Extension of time to file and pay

The Department [announced](#) that it would not assess penalties for failure to obtain a license, failure to file a return, or failure to pay a tax that was due on March 15, 2020, through July 15, 2020, if the corresponding license was obtained, the return was filed, or the tax was paid on or before July 15, 2020.

[Session Law 2020-3](#) did not provide the Secretary with the authority to waive interest on a withholding tax that was due during the COVID period. Consequently, interest cannot be waived for withholding taxes paid after the due date.

For additional information, see [NCDOR Actions on COVID-19](#).

### b. Withholding Requirements for Remote Workers

Because of the COVID-19 pandemic, many Americans work remotely. Thus, many employees work in a different location than where their employer is located. Some states have addressed this issue by providing emergency relief to employers and employees. In general, these states have indicated that during the COVID emergency period, employers should continue to treat a remote worker’s wages as if they were earned at the location where the employee worked prior to the COVID pandemic.

**As of the date of this publication, North Carolina has not modified its existing law with regard to nexus in North Carolina for business tax purposes.** If a nonresident employee who usually works in an office in North Carolina is working from the

nonresident employee's home outside of North Carolina due to COVID-19, the employer is not required to withhold North Carolina income taxes from the nonresident employee's wages that were earned for services performed outside of North Carolina.

For more information, see [Employees](#).

#### **4. Extension of Certain Appeal Deadlines**

Certain appeal deadlines that expired on or after April 1, 2020, and before July 15, 2020, were extended as long as the request or petition was filed on or before July 15, 2020. The extension applied to requests for Departmental review under [G.S. § 105-241.11](#), petitions for a contested case hearing at the Office of Administrative Hearings, and petitions for judicial review.

*Reference:* [Session Law 2020-3](#).

#### **5. CARES Act Decoupling**

The [Coronavirus Aid, Relief, and Economic Security Act](#) ("CARES Act") made a number of changes to the Internal Revenue Code ("Code"). To the extent North Carolina follows the Code as enacted as of May 1, 2020, these provisions apply to North Carolina for purposes of calculating an individual's income tax liability. However, North Carolina has specifically decoupled from certain provisions of the CARES Act. The following decoupling provisions are addressed in this Bulletin:

- [NOL Carryback Incurred in Tax Years 2018, 2019, and 2020](#)
- [NOL Carryforward Limitation for Tax Years 2018, 2019, and 2020](#)
- [Excess Business Loss Limitation for Tax Years 2018, 2019, and 2020](#)
- [Business Interest Expense Limitation](#)
- [Employer Payments of Student Loans](#)
- [Charitable Contribution Limitations](#)
- [Above-the-Line Deduction for Qualified Charitable Contributions](#)
- [Paycheck Protection Program Loan Forgiveness and Expenses](#)

#### **6. Extra Credit Grant Program**

##### **a. General**

On September 4, 2020, the [Coronavirus Relief Act](#) was signed into law. The law included the Extra Credit Grant Program, which was administered by the Department. The purpose of the program was to "use funds from the Coronavirus Relief Fund to help families with qualifying children in North Carolina by providing economic support to assist with virtual schooling and child-care costs during the COVID-19 pandemic."

**b. Eligibility**

The Department was required to award a grant to the following individuals:

- (1) **Automatic Grant Award:** Taxpayers who filed a 2019 North Carolina individual income tax return, [Form D-400](#), on or before October 15, 2020, as provided under [G.S. § 105-263](#), and who met the following conditions:
  - Reported on the Form D-400 that either the taxpayer or, if filing a joint return, the taxpayer's spouse, was a resident of North Carolina for the entire calendar year.
  - Reported at least one qualifying child on line 10a of Form D-400.
  
- (2) **Application for Grant Award:** Individuals who were not required to file a 2019 North Carolina individual income tax return solely because their gross income for 2019 did not exceed the filing requirement thresholds and who met the following conditions:
  - Completed and submitted an application for the Extra Credit Grant Program by October 15, 2020.
  - Reported on the application that the individual did not file a 2019 Form D-400 solely because the individual's gross income for 2019 did not exceed the State's filing requirements for the individual's filing status; and
  - Reported on the application that the individual was a North Carolina resident for the entire 2019 calendar year; and
  - Reported on the application that the individual had at least one qualifying child for whom the applicant would have been allowed a federal child tax credit for calendar year 2019.

**c. Deductibility for North Carolina Individual Income Tax Purposes**

Under the provisions of [Session Law 2020-97](#), the grant payment is not subject to North Carolina individual income tax. In calculating North Carolina taxable income, a taxpayer may deduct the amount of the grant **if the grant is included in federal adjusted gross income**. For more information, see [Deductions from Federal Adjusted Gross Income](#).

*Reference:* [Session Law 2020-97](#).

## II. Filing Individual Income Tax Returns

### 1. Forms

A taxpayer must use the North Carolina income tax return forms and schedules for the year that the taxpayer's tax year begins. The individual income tax return, [Form D-400](#), and other supporting forms and schedules can be obtained from the [Department's website](#). Form D-400 can also be obtained from the main office in Raleigh or from any of the Department's Service Centers located throughout the State. For locations and hours of operation, see [Office Locations](#) on the Department's website.

*Reference:* [17 NCAC 06B .0104](#); [17 NCAC 01C .0322](#).

### 2. Electronic Tax Filing (eFile)

The North Carolina Department of Revenue participates in the Federal/State eFile program, the fastest, safest, and most accurate way to file individual income tax returns. The eFile program, the number one Department-recommended method for filing and paying income taxes, allows residents, nonresidents, and part-year residents to file their federal and State tax returns in a single electronic transmission, or to file their State returns separate from their federal returns. It also allows direct deposit for tax refunds (checking or savings accounts only) and the filing of estimated tax, extensions, and bank payments. The eFile program features an acknowledgment and confirmation of receipt of tax forms.

Tax practitioners and taxpayers must eFile using Internal Revenue Service (IRS)-approved and Department-approved, commercially developed, software products. Visit [eFile for Individuals](#) to access a list of approved software developers and products. Using approved software, taxpayers can self-prepare their federal and State returns using eFile for a Fee, eFile for Free (for those who qualify), or use the services of a professional tax practitioner. Qualifications for eFile for Free and availability of functionality for estimated tax, extensions, and payments vary by software developer; therefore, tax practitioners and taxpayers should confirm product availability when selecting a developer. Regardless of the selected developer, eFile for Free must be accessed from the Department's website.

To participate in the Federal/State eFile program, a tax practitioner must have previously created an IRS e-services account and submitted an application to become an authorized IRS e-file provider. To participate in State eFile, the practitioner must have been accepted into the Federal program and must have received an Electronic Filing Identification Number (EFIN) from the IRS. The Department has access to the Federal Applicant Database that enables the Department to reference pertinent information regarding the tax practitioner.

*Reference:* [17 NCAC 01C .0701](#).

### 3. Items Requiring Special Attention

The individual taxpayer or the taxpayer's agent should give careful attention to the answering of all questions and to the completion of all applicable schedules on the return. Incomplete or inaccurate information, or the failure to sign a return, may result in the returning of the forms to the taxpayer, thereby delaying the processing of the return and any refund due thereon. Specifically, the individual taxpayer or the taxpayer's agent should give special attention to the following items:

- a. When filing an income tax return, the forms and schedules for that tax year must be used. For example, a taxpayer whose calendar year ends December 31, 2020, must use 2020 forms and schedules. A taxpayer filing on a fiscal year basis whose fiscal year begins in 2020 must also use the 2020 forms and schedules.
- b. The first name, middle initial, last name and the current mailing address of the taxpayer(s) should be printed in the appropriate boxes on the tax return. Do not use the name or address shown on a wage and tax statement if incorrect. Enter the entire nine-digit social security number of each taxpayer in the appropriate boxes.
- c. If you are a personal representative and you are filing an income tax return for an unmarried individual or a married filing separately return for a married individual who died during the taxable year, enter the name of the decedent and your address in the "Name and Address" section of Form D-400. In the "Deceased Taxpayer Information" section, fill in the circle and enter the taxpayer's date of death in the appropriate box.
- d. If you are a surviving spouse and you choose to file a married filing joint tax return with your spouse who died during the taxable year, enter your name, the name of the decedent, and your address in the "Name and Address" section of Form D-400. In the "Deceased Taxpayer Information" section, fill in the circle and enter the date of the decedent's death in the appropriate box.
- e. If you are a surviving spouse and you choose to file a married filing separately tax return for your spouse who died during the taxable year, enter the name of the decedent and your address in the "Name and Address" section of Form D-400. In the "Deceased Taxpayer Information" section, enter the date of the decedent's death in the appropriate box.
- f. The taxpayer is required to furnish a social security number with the return. This number is necessary to verify the identity of the taxpayer because the Department identifies taxpayers and credits refunds and payments by social security number. Separate returns of spouses are often interrelated whether they are living together or apart; therefore, the taxpayer is asked to furnish the name and social security number of the spouse if they file on separate forms, but not if they are divorced. This information can save time, correspondence, and difficulty for the taxpayer and the Department.
- g. The filing status claimed on the federal return must also be claimed on the North Carolina income tax return. Generally, if the taxpayer has not filed a federal income tax return, the

taxpayer must claim the filing status to which the taxpayer is entitled under the Internal Revenue Code. However, for a married couple filing a joint federal income tax return, if either the taxpayer or the taxpayer's spouse is a nonresident and has no North Carolina taxable income for the taxable year, the filing status married filing separately may be claimed on the North Carolina income tax return. Importantly, once a joint return is filed, separate returns may not be filed for that year after the due date of the return.

- h. The tax must be computed accurately by multiplying North Carolina taxable income by the tax rate in [G.S. 105-153.7](#). In the case of a delinquent return, the penalties prescribed by [G.S. 105-236\(a\)\(3\)](#) and [G.S. 105-236\(a\)\(4\)](#) and interest prescribed by [G.S. 105-241.21](#) must be added.
- i. If additional tax is due on the income tax return, it can be paid by check or money order with the return, or it can be paid online by bank draft (free) or credit or debit card using Visa or MasterCard (\$2 convenience fee for every \$100 paid). To pay online, see [eFile for Individuals](#).

**Note:** The Department will not accept a check, money order, or cashier's check unless it is drawn on a U.S. (domestic) bank and the funds are payable in U.S. dollars.

- j. If an individual has moved into or out of North Carolina during the tax year or is a nonresident with income from sources within North Carolina, the portion of the taxpayer's federal gross income, as adjusted, that is subject to North Carolina income tax must be determined by completing [Form D-400 Schedule PN](#), Part Year Resident and Nonresident Schedule.

**Note:** Taxpayers required to complete [Form D-400 Schedule PN](#) must review [Form D-400 Schedule PN-1](#) to determine if they need to report North Carolina adjustments that relate to gross income that were not specifically listed on [Form D-400 Schedule PN](#). North Carolina adjustments that relate to gross income for tax year 2020 that do not have a designated line on [Form D-400 Schedule PN](#) for tax year 2020 are listed on [Form D-400 Schedule PN-1](#) for tax year 2020.

- k. Credit for tax paid to another state is not allowed to an individual moving into or out of this state unless the individual has income derived from and taxed by another state or country while a resident of this State. For more information, see [Credit for Income Tax Paid to another State or Country](#).
- l. If a tax credit is claimed for tax paid to another state or country, a copy of the return filed with the other state or country and a canceled check, receipt, or other proof of payment of tax to the other state must be attached to the North Carolina return.
- m. Every return must be signed and dated by the taxpayer or the taxpayer's authorized agent, and joint returns should be signed and dated by both spouses. A refund may be delayed by an unsigned return. The affirmation statement for the D-400 states that upon signing the return, the taxpayer is declaring and certifying that the taxpayer has examined the return



and all accompanying schedules and statements, and that they are true, correct, and complete.

- n. Where tax has been withheld, the original or copy of the original State wage and tax statement that was received from an employer must be attached to the return. Wage and tax statements or 1099 statements generated by tax software programs cannot be used to verify North Carolina tax withheld. The Department may request the original State wage and tax statements to verify tax has been withheld from taxpayers that file electronically.
- o. Any additional information that will assist in the processing and examination of a return should be attached to the return. If [Form NC-478](#) or [Form NC-Rehab](#) are being filed, the form(s) must be attached to the front of Form D-400.
- p. Anyone who is paid to prepare a return must sign and date the return in the space provided. When more than one person prepares a return, the preparer with primary responsibility for the overall accuracy of the return must sign as the preparer. The preparer must manually sign and date the prepared return. Preparers may use the practitioner ID number (PTIN) in lieu of their social security number. Preparers should also include their phone numbers in the space provided.

**Note:** A taxpayer and the taxpayer's spouse, if filing a joint return, can authorize the Department to discuss the return and attachments with the paid preparer of the return by checking the applicable box in the signature area of the return. Importantly, the authorization applies only to the individual whose signature appears in the "Paid Preparer Use Only" section of the return. The authorization does not apply to the firm, if any, shown in the paid preparer section.

- q. Nonresident aliens are required to file income tax returns at the same time they are required to file their federal returns.
- r. Individuals performing disaster-related work in North Carolina during a disaster response period at the request of a critical infrastructure company should review the information provided in [Critical Infrastructure Disaster Relief Work](#).

*Reference:* [17 NCAC 06B .0102](#); [17 NCAC 06B .0104](#); [17 NCAC 01C .0322](#).

#### **4. Substitute Returns**

Any facsimile or substitute form must be approved by the Department prior to its use. The guidelines for producing substitute forms are available in the publication, "Requirements for the Approval of Substitute Tax Forms." An electronic copy of the publication may be obtained by making a request to the "Vendor Support Unit" at "allaboutforms@ncdor.gov" or by calling (919) 754-2625.

If you use computer-generated returns, the software company is responsible for requesting and receiving an assigned software developer identification. To obtain a list of approved software

developers, see [List of Approved Tax Forms of Software Developers](#). Photocopies of the return are not acceptable. Returns that cannot be processed by the Department's imaging and scanning equipment may be returned to the taxpayer with instructions to refile on an acceptable form.

*Reference:* [17 NCAC 01C .0601](#).

## 5. Federal Forms

Taxpayers must include a copy of their federal return with the North Carolina return unless their federal return reflects a North Carolina address.

*Reference:* [17 NCAC 06B .0106](#).

## 6. Extensions

### a. General

If you cannot file your North Carolina Individual Income Tax Return, [Form D-400](#), by the original due date of the return, you may apply for a six-month extension of time to file the return. The original due date of the individual income tax return for calendar year taxpayers is April 15<sup>th</sup>. For taxpayers with a fiscal year end, the original due date of the individual income tax return is the fifteenth day of the fourth month following the close of the fiscal year.

A taxpayer who is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina income tax return. In order to receive an automatic State extension, the taxpayer must certify on the North Carolina tax return that the person was granted an automatic federal extension.

A taxpayer who is not granted an automatic extension to file a federal income tax return must file [Form D-410](#), Application for Extension for Filing Individual Income Tax Return, by the original due date of the return in order to receive an extension for North Carolina income tax purposes. Without a valid extension, an individual income tax return filed after the original due date is delinquent and subject to interest and all applicable penalties provided by law. For information on applicable penalties and interest, see [Penalties and Interest](#).

You are not required to send a payment of the tax you expect to owe to receive an extension; however, it will benefit you to pay as much as you can by the original due date. An extension of time may be granted even if the application for extension is not accompanied by a payment of the tax due. However, an extension of time for filing a tax return does not extend the time for paying the tax due. If you do not pay the amount of tax due by the original due date, you will owe a ten percent (10%) late payment penalty and interest. The late payment penalty will not be due if you pay at least 90 percent (90%) of your tax liability through withholding, estimated tax payments, or with [Form D-410](#) by the original due date.

If your return is complete by the original due date but you are not able to pay the tax you owe, you should not request an extension. Instead, file your return by the original due date and pay as much tax as you can to minimize any penalties and interest due. You must also request an extension if you expect a refund but cannot file your return by the original due date. You will not receive your refund until you file your income tax return.

*Reference:* [17 NCAC 06B .0107](#); [G.S. § 105-263](#).

#### **b. Out of Country Extension**

If you are required to file a North Carolina individual income tax return and you are out of the country on the original due date of the return, you are granted an automatic four-month extension for filing your North Carolina individual income tax return if you fill in the “Out of Country” circle on Page 1 of [Form D-400](#). “Out of Country” means you live outside the United States and Puerto Rico and your main place of work is outside the United States and Puerto Rico, or you are in military service outside the United States and Puerto Rico. The time for payment of the tax is also extended; however, interest is due on any unpaid tax from the original due date until the tax is paid.

If you are unable to file your income tax return within the automatic four-month extension period, an additional two-month extension may be obtained by filling in the circle at the bottom right of Form D-410 or selecting “Y” at the “Out of country on due date prompt” on the Department’s personalized form creator. To receive the additional two-month extension, [Form D-410](#) must be filed by August 15. Importantly, a taxpayer who is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding State income tax return if they certify on the State return that the federal extension was granted. Consequently, an “Out of Country” taxpayer granted an automatic six-month extension to file the State income tax return will not be required to file Form D-410 to receive the additional two-month extension.

*Reference:* [17 NCAC 06B .0107](#); [G.S. § 105-263](#).

#### **c. Filing an Extension**

You can apply for a North Carolina extension and pay your tax online using the following options:

- [eFile](#) – File Form D-410 and remit your tax payment using a tax professional or commercial tax preparation software (**see list of approved eFile vendors**). Using eFile allows you to file federal and State forms at the same time or separately. Free eFile is available for those who qualify.
- [Online File and Pay](#)– file Form D-410 and remit your tax payment using the Department’s website (no access to federal filing and paying).

If you are unable to apply for an extension and pay your tax online or if you want to file your extension in paper form, you can create a [personalized Form D-410](#).

For more information on applying for an extension, see [Extensions](#) and [Frequently Asked Questions about Filing an Application for Extension to File Your N.C. Individual Income Tax Return](#).

## 7. Amended Returns

If you need to amend your **2020** individual income tax return, complete and file (1) [Form D-400](#) (fill in the applicable Amended Return circle), (2) [Form D-400 Schedule AM](#), and (3) any applicable schedules (i.e. [Form D-400, Schedule S](#), [Form D-400 Schedule A](#), [Form D-400 Schedule PN](#), [Form D-400 Schedule PN-1](#), and [Form D-400TC](#)).

**For tax years 2015 through 2019**, complete and file that year's Form D-400, Form D-400, Schedule AM, and any applicable schedules.

**For tax years 2012, 2013, or 2014**, use the appropriate tax year's Form D-400X for filing an amended return.

**For tax years 2009 through 2011**, complete a corrected Form D-400, Individual Income Tax Return, with the amended indicator filled in for the tax year being amended. Individuals must also complete Form D-400X-WS, Worksheet for Amending Individual Income Tax Return, and attach it to the front of the corrected Form D-400, Individual Income Tax Return. Do not send a copy of the original return.

**For tax year 2008 or prior**, use Form D-400X, Amended North Carolina Individual Income Tax Return. Prior years' individual income tax returns can be obtained from the [Department's website](#).

Generally, amended returns on which you owe additional tax must be filed and the tax paid within three years after the date on which the original return was filed or within three years from the date required by law for filing the return, whichever is later. Amended returns requesting a refund must be filed within the [statute of limitations for refunds](#).

If a taxpayer files an amended return with the Internal Revenue Service that contains an adjustment that would increase the amount of State tax payable, the taxpayer must file an amended North Carolina return within six months of filing the federal amended return. If the taxpayer does not timely file the amended North Carolina return, the Department may propose an assessment within three years from the date the return was due to be filed or three years from the date the federal amended return was filed with the Internal Revenue Service, whichever is later. The date the federal amended return was filed is presumed to be the date recorded by the Internal Revenue Service. If a taxpayer files an amended return with the Internal Revenue Service that contains an adjustment that would decrease the amount of State tax payable, the taxpayer may file an amended North Carolina return subject to the requirements of [G.S. § 105-241.6](#).

If the Internal Revenue Service makes changes to an individual's federal return, the individual must report the changes to the State by filing an amended return within six months from the date the report from the Internal Revenue Service is received by the taxpayer. If an individual does not amend the State return to reflect the federal changes and the Department receives the report from the Internal Revenue Service, an assessment may be made by the Department within three years from the date of receipt of the report, and the individual's right to any refund which might have been due by reason of the change is forfeited.

For more information on filing an amended tax return within the statute of limitations, see [G.S. § 105-159](#), [G.S. § 105-241.6](#), [G.S. § 105-241.7](#), [G.S. § 105-241.8](#), [G.S. § 105-241.9](#), and the [Department's Important Notice dated July 13, 2016](#). Additional guidance can also be obtained later in this document; see [Statute of Limitations](#) and [Federal Determinations](#).

## **8. Tax Rate**

For taxable years beginning on or after January 1, 2019, the individual income tax rate is 5.25%. For more information, see [Tax Rates Schedules](#).

*Reference:* [G.S. § 105-153.7](#).

## **9. Time and Place for Filing**

The due date for filing a calendar year end individual income tax return is generally April 15th of each year. For taxpayers reporting on a fiscal year end (a tax year ending on the last day of any month other than December), the due date for filing an individual income tax return is the 15th day of the fourth month following the close of the fiscal year. For information on when a document is considered timely filed, see [Departmental Directive TA-16-1](#) and [Departmental Directive TA-18-1](#).

*Reference:* [G.S. § 105-155](#).

## III. Filing Requirements

### 1. General

The minimum gross income filing requirements under North Carolina law are different from the filing requirements under the Internal Revenue Code because North Carolina law does not allow the same standard deduction amount as the Internal Revenue Code.

*Reference:* [17 NCAC 06B .0109.](#)

### 2. Individuals Required to File a North Carolina Individual Income Tax Return

The following individuals are required to file a 2020 North Carolina individual income tax return:

- a. Every resident of North Carolina whose gross income for the taxable year exceeds the amount shown in the Filing Requirements Chart for Tax Year 2020 in subsection 3 for the individual's filing status.
- b. Every part-year resident who received income while a resident of North Carolina or who received income while a nonresident that was (1) attributable to the ownership of any interest in real or tangible personal property in North Carolina, or (2) derived from a business, trade, profession, or occupation carried on in North Carolina, or (3) derived from gambling activities in North Carolina and whose total gross income for the taxable year exceeds the amount shown in the Filing Requirements Chart for Tax Year 2020 in subsection 3 for the individual's filing status.
- c. Every nonresident who received income for the taxable year from North Carolina sources that was (1) attributable to the ownership of any interest in real or tangible personal property in North Carolina, or (2) derived from a business, trade, profession, or occupation carried on in North Carolina, or (3) derived from gambling activities in North Carolina and whose total gross income from all sources both inside and outside of North Carolina for the taxable year exceeds the amount shown in the Filing Requirements Chart for Tax Year 2020 in subsection 3 for the individual's filing status. For nonresident businesses and employees engaged in disaster relief work at the request of a critical infrastructure company, see [Critical Infrastructure Disaster Relief Work](#).

*Reference:* [G.S. § 105-153.8.](#)

### 3. Minimum Gross Income Filing Requirements

Resident individuals who have gross income that exceeds the North Carolina standard deduction must file a North Carolina individual income tax return. Nonresident individuals who have gross income that exceeds the North Carolina standard deduction and receive gross

income derived from North Carolina sources must file a North Carolina individual income tax return. The following Filing Requirements Chart shows the minimum gross income filing requirements for tax year 2020.

**Note:** If an individual was not required to file a federal income tax return but had total gross income inside and outside North Carolina that exceeds the amount shown in the Filing Requirements Chart for Tax Year 2020 for the individual’s filing status, a federal return must be completed and attached to the North Carolina return to show how the federal adjusted gross income and deductions were determined.

<b>Filing Requirements Chart for Tax Year 2020</b>	
<u><b>Filing Status</b></u>	<u><b>A Return is Required if Federal Gross Income Exceeds</b></u>
(1) Single .....	\$ 10,750
(2) Married - Filing Joint Return .....	\$ 21,500
(3) Married - Filing Separate Return	
If spouse does not claim itemized deductions.....	\$ 10,750
If spouse claims itemized deductions .....	0
(4) Head of Household .....	\$ 16,125
(5) Qualifying widow(er) with dependent child (Surviving Spouse)	\$ 21,500
(6) Nonresident alien (regardless of filing status) .....	\$ 0

Reference: [G.S. § 105-153.8\(a\)](#).

#### 4. Joint Returns

[G.S. § 105-153.8\(e\)](#) requires a married couple to file a joint State income tax return if:

- a. They file a joint federal income tax return, and
- b. Both spouses are residents of North Carolina or both spouses had North Carolina taxable income.

Generally, all other individuals may file separate returns.

On joint returns, both spouses are jointly and severally liable for the tax due. A spouse will be allowed relief from a joint State income tax liability if the spouse qualifies for innocent spouse relief of the joint federal tax liability under Code section 6015.

A married couple who files a joint federal income tax return may file a joint State return even if one spouse is a nonresident and had no North Carolina income. However, the spouse required to file a North Carolina return has the option of filing the State return as married filing

separately. Once a married couple files a joint return, they cannot choose to file separate returns for that year after the due date of the return. If an individual chooses to file a separate North Carolina return, the individual must complete either a federal return as married filing separately, reporting only that individual's income and deductions, or a schedule showing the computation of that individual's separate income and deductions and attach it to the North Carolina return. In addition, a copy of the complete joint federal return must be included unless the federal return reflects a North Carolina address.

Itemized nonbusiness deductions of a married couple may be claimed by a spouse only if that spouse was obligated to pay the items and actually paid the amount during the year. In the case of a joint obligation (such as mortgage interest and real estate taxes), the deduction is allowable to the spouse who actually paid the item.

*Reference:* [G.S. § 105-153.8\(e\); 17 NCAC 06B .0112.](#)



## IV. Computation of North Carolina Taxable Income

### 1. General

The starting point for determining North Carolina taxable income is federal adjusted gross income. Therefore, a taxpayer must determine federal adjusted gross income before beginning the North Carolina return. If the taxpayer is not filing a federal income tax return, the taxpayer must complete a schedule showing the computation of federal adjusted gross income and deductions. The taxpayer must attach the schedule to the North Carolina income tax return.

*Reference:* [G.S. § 105-153.4](#); [17 NCAC 06B.0014](#).

### 2. Additions to Federal Adjusted Gross Income

Federal adjusted gross income must be increased by certain additions to the extent the amounts are not included in federal adjusted gross income. A taxpayer must report the additions by completing Part A of [Form D-400 Schedule S](#), North Carolina Supplemental Schedule. These additions include the following:

- a. Interest received from notes, bonds, and other obligations of states other than North Carolina and their political subdivisions. Under this statute, an individual is required to add the total of such interest to federal adjusted gross income even though the individual may have incurred expenses in earning the interest. This addition includes that portion of an exempt interest dividend from a regulated investment company (mutual fund) that represents interest on direct obligations of states other than North Carolina and their political subdivisions. For more information, see [Taxable Status of Distributions from Regulated Investment Companies](#).
- b. A shareholder of an S corporation is required to make an addition to federal adjusted gross income for the shareholder's share of built-in gains tax that the S corporation paid for federal income tax purposes. Because the income subject to the built-in gains tax is taxed at both the S corporation and shareholder level for federal income tax purposes, federal law allows the shareholder to deduct the shareholder's pro rata share of the built-in gains tax to provide relief from double taxation. North Carolina does not impose a built-in gains tax; therefore, there is no double taxation for State income tax purposes.
- c. The amount by which the basis of property for federal purposes exceeds the basis for State purposes must be added to adjusted gross income in the year that the property is disposed of.
- d. The amount required to be added under [G.S. § 105-153.6](#) when the State decouples from federal accelerated depreciation and expensing.

## 1. Federal Accelerated (Bonus) Depreciation

Taxpayers are required to add to federal adjusted gross income 85% of the amount allowed as a bonus depreciation deduction under section 168(k) or 168(n) of the Code for property placed in service during the year. This adjustment does not result in a difference in basis of the affected assets for State and federal income tax purposes.

A percentage of the federal bonus depreciation allowed under sections 168(k) and (n) of the Code is required as an add-back to federal adjusted gross income. If an addition is required and made by a taxpayer, the taxpayer may deduct 20% of the amount of the bonus depreciation add-back in the first five taxable years following the year the taxpayer is required to include the add-back in income.

For further guidance, see [Bonus Asset Basis](#), and [Adjustment for Bonus Depreciation](#).

## 2. Section 179 Expensing Limitations

Beginning with tax year 2010, North Carolina did not conform to the same Code section 179 expensing limitations allowed for federal income tax purposes. Instead, North Carolina has separate dollar and investment limitations, as follows:

<b><u>Tax Year</u></b>	<b><u>NC Dollar Limitation</u></b>	<b><u>NC Investment Limitation</u></b>
2010	\$250,000	\$800,000
2011	\$250,000	\$800,000
2012	\$250,000	\$800,000
2013 and forward	\$ 25,000	\$200,000

In addition, taxpayers placing section 179 property in service during these years are required to add to federal adjusted gross income 85% of the federal section 179 deduction in excess of the amount allowed using the North Carolina limits shown in the above table. If an addition is required and made by a taxpayer, the taxpayer may deduct 20% of the section 179 add-back in the first five taxable years following the year the taxpayer is required to include the add-back in income.

For further guidance, see [Income Tax Adjustments for Code Section 179 Expenses](#).

- e. The amount of net operating loss carried to and deducted in arriving at adjusted gross income on the federal return that is not absorbed in that year and will be carried forward to a subsequent year. See [Net Operating Losses](#) for additional information.
- f. The amount contributed to an account in the Parental Savings Trust Fund of the State Education Assistance Authority to the extent the amount was deducted in a prior taxable year under G.S. § 105-134.6(d)(4) if this amount is withdrawn from the Parental Savings Trust Fund and not used to pay for the qualified expenses of the designated beneficiary or rolled into a qualified 529 ABLÉ account. An individual does not have to add to federal adjusted gross income the amount of funds withdrawn if the funds are used for a purpose

allowed under section 529 of the Code, as amended by the federal Tax Cuts and Jobs Act of 2017.

- g. Section 1400Z-2 of the Code includes a provision that provides a tax benefit to a qualified investor who invests capital gains into qualifying Opportunity Zones. North Carolina did not conform to the Code with respect to the following:
1. Taxpayers are required to add to federal adjusted gross income the amount of gain temporarily excluded from the taxpayer's gross income under section 1400Z-2 of the Code because the gain was reinvested into a qualified Opportunity Fund as defined under the Code. The adjustment made to federal adjusted gross income does not result in a difference in basis of the affected assets for State and federal income tax purposes.
  2. Taxpayers are allowed to deduct the amount of gain included in federal adjusted gross income under section 1400Z-2 of the Code to the extent the same income was included in the taxpayer's North Carolina taxable income in a prior tax year.
  3. Taxpayers are required to add to federal adjusted gross income the amount of gain permanently excluded from the taxpayer's gross income under section 1400Z-2 of the Code because the gain was accrued from the sale or exchange of an investment in an Opportunity Fund held for at least 10 years. For more information, see the Department's [Important Notice](#) issued on August 21, 2018.
- h. The amount of the discharge of qualified principal residence indebtedness excluded from federal gross income under section 108 of the Code.

The Further Consolidated Appropriations Act ("FCAA") retroactively extended through tax year 2020 the exclusion from gross income for the discharge of qualified principal residence indebtedness under section 108 of the Code. North Carolina did not adopt this provision of the Code. **Note:** If the taxpayer is insolvent, as defined in section 108(d)(3) of the Code, then the addition required under this subdivision is limited to the amount of discharge of qualified principal residence indebtedness excluded from adjusted gross income under section 108(a)(1)(E) of the Code that exceeds the amount of discharge of indebtedness that would have been excluded under section 108(a)(1)(B) of the Code.

- i. The amount deducted from federal adjusted gross income for qualified tuition and related expenses under section 222 of the Code.

The FCAA retroactively extended through tax year 2020 the deduction in arriving AGI for qualified tuition and related expenses under section 222 of the Code. North Carolina did not adopt this provision of the Code.

- j. The amount of a Net Operating Loss ("NOL") carryforward deduction taken in 2020 for an NOL incurred in tax years 2018 or 2019 to the extent that the federal deduction exceeds the amount allowed under the provisions of Code § 172 as enacted as of January 1, 2019.

The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) suspended the 80% NOL carryforward deduction limitation under Code § 172 until tax year 2021 for NOLs incurred during tax years 2018, 2019, and 2020. North Carolina did not adopt this provision of the Code. **Note:** The amount added back to a taxpayer’s AGI may be deducted in five equal installments beginning in tax year 2021. For more information, see [Net Operating Losses](#).

- k. The amount of the taxpayer's excess business loss, as defined under the provisions of section 461(l) of the Code as enacted as of January 1, 2019.

The CARES Act suspended the Code § 461(l) excess business loss limitation for tax years 2018, 2019, and 2020. North Carolina did not adopt this provision of the Code. **Note:** The amount added back to a taxpayer’s AGI may be deducted in five equal installments beginning in tax year 2021. For addition information, see [Excess Business Losses](#).

- l. The amount by which the individual’s interest expense deduction under section 163(j) of the Code exceeds the interest expense deduction that would have been allowed under section 163(j) of the Code as enacted as of January 1, 2020.

Under the Tax Cuts and Jobs Act (“TCJA”), the amount of business interest expenses deductible in a tax year could not exceed the sum of: (1) the taxpayer’s business interest income for the tax year, (2) 30% of the taxpayer’s adjusted taxable income (“ATI”) for the year, and (3) the taxpayer’s floor plan financing interest expense for the year. The CARES Act temporarily increased the limit on the amount of business interest expenses deductible from 30% of a taxpayer’s ATI to 50% of a taxpayer’s ATI for tax years 2019 and 2020. North Carolina did not adopt this provision of the Code. Instead, for North Carolina tax purposes, the business interest expense deduction remains at 30% of an individual’s ATI (i.e., pre-CARES Act).

- m. The amount excluded from the taxpayer's gross income for payment by an employer of principal or interest on any qualified education loan, as defined in section 221(d)(1) of the Code, incurred by the taxpayer for education of the taxpayer.

The CARES Act excluded certain employer payments of student loans under IRC § 127(c) from gross income for tax year 2020. North Carolina did not adopt this provision of the Code.

- n. The amount of qualified charitable contributions deducted in calculating federal adjusted gross income under IRC section 62(a)(22).
- o. The amount of any expenses that would normally be deductible under the Code to the extent that payment of the expense resulted in forgiveness of a Paycheck Protection Program (“PPP”) loan. **Important:** The CARES allows an eligible individual to exclude the amount of a forgiven Paycheck Protection Program (“PPP”) loan from gross income. North Carolina adopted this provision of the Code.

*Reference:* [G.S. § 105-153.5](#); [G.S. § 105-153.6](#); [Session Law 2020-58](#).

### 3. Deductions from Federal Adjusted Gross Income

Federal adjusted gross income may be decreased by the following deductions to the extent the amounts are included in federal adjusted gross income. A taxpayer may report the deductions by completing Part B of [Form D-400 Schedule S](#), North Carolina Supplemental Schedule. These deductions include the following:

**a.** Interest received from notes, bonds, and other obligations of any of the following:

**1.** The United States or its possessions.

Interest earned from obligations that are merely backed or guaranteed by the United States Government will not qualify for deduction from an individual's income. The deduction from income will not apply to distributions which represent gain from the sale or other disposition of the securities, nor to interest paid in connection with repurchase agreements issued by banks and savings and loan associations. The deduction will not apply to any portion of a distribution from an individual retirement account (IRA). For more information, including examples, see [Interest from Obligations of the United States](#).

**2.** The State of North Carolina or any of its political subdivisions. For more information, including examples, see [Income from North Carolina Obligations](#).

**3.** A nonprofit educational institution organized or chartered under North Carolina law.

**4.** A hospital authority created under [G.S. § 131E-17](#).

**b.** Gain from the disposition of obligations issued before July 1, 1995, if North Carolina law under which the obligations were issued specifically exempts the interest or gain. (With respect to North Carolina obligations issued after July 1, 1995, the income tax treatment of gains from the sale or disposition of such obligations is the same for federal and State purposes.)

**c.** Taxable portion of social security benefits received under Title II of the Social Security Act and any Tier I or Tier II Railroad Retirement benefits received under the Railroad Retirement Act of 1937.

**d.** Refunds of state, local, and foreign income taxes.

**e.** Income earned or received by an enrolled member of a federally recognized Indian tribe if such income is derived from activities on a federally recognized Indian reservation while the member resided on the reservation. Intangible income having a situs on the reservation and retirement income associated with activities on the reservation are considered income derived from activities on the reservation.

- f. The amount by which the basis of property for State purposes exceeds the basis for federal purposes must be deducted from adjusted gross income in the year that the property is disposed of. The deduction can be claimed only in the year in which the property is disposed.
- g. The amount received during the taxable year from one or more State, local, or federal government retirement plans to the extent the amount is exempt from North Carolina individual income tax pursuant to a court order in settlement of any of the following cases:
  - Bailey v. State, 92 CVS 10221, 94 CVS 6904, 95 CVS 8230.
  - Emory v. State, 98 CVS 0738.
  - Patton v. State, 95 CVS 04346.

For more information, see [Bailey Settlement](#).

- h. An amount equal to 20% of the bonus depreciation deduction added to federal adjusted gross income on the 2015, 2016, 2017, 2018, and 2019 State returns. For more information, see [Adjustment for Bonus Depreciation](#).
- i. An amount equal to 20% of the section 179 expense deduction added federal adjusted gross income on the 2015, 2016, 2017, 2018, and 2019 State returns. For more information, see [Income Tax Adjustments for Code Section 179 Expense](#).
- j. The amount by which a deduction for an ordinary and necessary business expense was required to be reduced or was not allowed in arriving at federal adjusted gross income because the taxpayer claimed a federal tax credit for those expenses instead of a deduction. The deduction is allowed only to the extent that a similar credit is not allowed against the North Carolina income tax liability for the expenses.
- k. The amount of gain included in federal adjusted gross income under section 1400Z-2 of the Code to the extent the same income was included in the taxpayer's North Carolina taxable income in a prior tax year. For more information, see the Department's [Important Notice](#) issued on August 21, 2018.
- l. The amount deposited during the taxable year to a personal education savings account ("PESA") under Article 41 of Chapter 115C of the General Statutes, "Personal Education Savings Accounts," to the extent the deposit was included in adjusted gross income.
- m. The amount paid to a taxpayer during the taxable year from the State Emergency Response and Disaster Relief Reserve Fund for hurricane relief or assistance. A taxpayer may not deduct any payment made to the taxpayer for goods or services provided by the taxpayer.

- n. The amount received by a taxpayer as an economic incentive pursuant to G.S. 143B-437.012 or Part 2G or Part 2H of Article 10 of Chapter 143B of the General Statutes.
- o. The amount received by a taxpayer as a grant payment under the Extra Credit grant program. For more information, see [Extra Credit Grant Program](#).

*Reference:* : [G.S. § 105-153.5](#); [G.S. § 105-153.6](#); [17 NCAC 06B .0116](#); [Session Law 2020-97](#).

#### 4. North Carolina Child Deduction

[G.S. § 105-153.5\(a1\)](#) allows a taxpayer a deduction for each qualifying child for whom the taxpayer is allowed a federal child tax credit under section 24 of the Internal Revenue Code. The deduction amount is equal to the amount listed in the table below based on the taxpayer's adjusted gross income (AGI), as calculated under the Code:

<b>Filing Status</b>	<b>AGI</b>	<b>Deduction Amount</b>
Married, filing jointly/Qualifying Widow(er)/Surviving Spouse	Up to \$40,000	\$2,500
	Over \$40,000 Up to \$60,000	\$2,000
	Over \$60,000 Up to \$80,000	\$1,500
	Over \$80,000 Up to \$100,000	\$1,000
	Over \$100,000 Up to \$120,000	\$500
	Over \$120,000	\$0
	Head of Household	Up to \$30,000
Over \$30,000 Up to \$45,000		\$2,000
Over \$45,000 Up to \$60,000		\$1,500
Over \$60,000 Up to \$75,000		\$1,000
Over \$75,000 Up to \$90,000		\$500
Over \$90,000		\$0
Single/Married, filing separately		Up to \$20,000
	Over \$20,000 Up to \$30,000	\$2,000
	Over \$30,000 Up to \$40,000	\$1,500
	Over \$40,000 Up to \$50,000	\$1,000
	Over \$50,000 Up to \$60,000	\$500
	Over \$60,000	\$0

Reference: [G.S. § 105-153.5\(a1\)](#).



## 5. North Carolina Standard Deduction

In calculating North Carolina taxable income, an individual may deduct from adjusted gross income either the North Carolina standard deduction or North Carolina itemized deductions, whichever is applicable.

The standard deduction for most individuals for tax year 2020 can be found in the following chart. However, the standard deduction is zero for persons who are not eligible for the federal standard deduction under section 63 of the Code. You are not eligible for the federal standard deduction if: (1) you are married filing a separate return for federal income tax purposes and your spouse itemizes deductions, (2) you are a nonresident alien, or (3) you are filing a short-year tax return because of a change in your accounting period. In general, a nonresident alien is an alien (not a U.S. citizen) who has not passed the green card test or the substantial presence test. *(For more information on the green card test and the substantial presence test, see federal Publication 519, U.S. Tax Guide for Aliens).*

<b>N.C. Standard Deduction Chart for Tax Year 2020</b>	
<b>If your filing status is:</b>	<b>Your standard deduction is:</b>
Single	\$ 10,750
Married filing jointly/Qualifying Widow(er)/ Surviving Spouse	\$ 21,500
Married filing separately	
If spouse does not claim itemized deductions	\$ 10,750
If spouse claims itemized deductions	\$ 0
Head of household	\$ 16,125

Reference: [G.S. § 105-153.5\(a\)\(1\)](#).

## 6. North Carolina Itemized Deductions

North Carolina itemized deductions are not identical to federal itemized deductions and are subject to certain limitations. Specifically, no itemized deductions included on federal Form 1040 Schedule A are allowed as North Carolina itemized deductions except qualified mortgage interest, real estate property taxes, charitable contributions, medical and dental expenses, and repayment of claim of right income.

**Important.** Individuals must complete [Form D-400 Schedule A](#), and attach the schedule to [Form D-400](#) if N.C. itemized deductions are claimed.

The North Carolina itemized deductions are as follows:

**a. Qualified Mortgage Interest and Real Estate Property Taxes.**

The sum of qualified home mortgage interest and real estate property taxes claimed under sections 163(h) and 164 of the Code, respectively, may not exceed \$20,000. For spouses filing as married filing separately or married filing jointly, the total home mortgage interest and real estate taxes claimed by both spouses combined may not exceed \$20,000. For spouses filing as married filing separately with a joint obligation for home mortgage interest and real estate taxes, the deduction for these items is allowable to the spouse who actually paid them. If the amount of the home mortgage interest and real estate taxes paid by both spouses exceeds \$20,000, these deductions must be prorated based on the percentage paid by each spouse. For joint obligations paid from joint accounts, the proration is based on the income reported by each spouse for that taxable year.

**Important.** For taxable years 2018 through 2025, Code section 164 limits the amount of the deduction for state and local tax (SALT) payments to \$10,000 (\$5,000 in the case of a married individual filing a separate return). State and local taxes include state and local real property taxes, state and local personal property taxes, and state and local income taxes (or state and local general sales taxes claimed in lieu of state and local income taxes). Thus, an individual who files a North Carolina joint return with a spouse, a single return, or a return as head of household may not deduct more than \$10,000 of real estate taxes paid or accrued for the taxable year as a North Carolina itemized deduction. An individual who files a North Carolina return as married filing separately may not deduct more than \$5,000 of real estate taxes. Importantly, if the taxpayer deducts the maximum \$10,000 for real estate taxes paid or accrued during the taxable year on the State return, the taxpayer can also deduct up to \$10,000 for mortgage expenses paid or accrued if the mortgage expense meets statutory requirements.

If the aggregate amount of the SALT payments exceeds \$10,000 such that the taxpayer cannot deduct the full amount of SALT payments on the federal tax return, and the amount of property tax paid during the year exceeds \$10,000, the taxpayer can deduct \$10,000 in real property tax paid for State tax purposes.

**Example 1.** An individual filing a single return has a state income tax expense of \$10,000 and a real property tax expense of \$12,000.

Under federal law, the taxpayer can only claim \$10,000 of the \$22,000 (\$10,000 + \$12,000) as an itemized deduction. Under State law, the taxpayer may claim \$10,000 in real property tax paid.

**Example 2.** A married couple filing a joint return has a state income tax expense of \$10,000 and a real property tax expense of \$7,000.

Under federal law, the taxpayers can only claim \$10,000 of the \$17,000 (\$10,000 + \$7,000) as an itemized deduction. Under State law, the taxpayers may claim \$7,000 in real property tax paid.

**Note:** The Further Consolidated Appropriations Act (“FCAA”), enacted by Congress in December 2019, extended through tax year 2020 the federal provision that allows an individual an itemized deduction for mortgage insurance premiums paid or accrued by treating those premiums as qualified residence interest. North Carolina did not adopt this provision of the Code. An individual is not allowed a North Carolina itemized deduction for mortgage insurance premiums paid during the year and treated as qualified residence interest under the Code for tax years 2014 through 2020.

**b. Charitable Contributions**

Charitable contributions allowed as a deduction under section 170 of the Code are allowed. However, for tax year 2020, North Carolina decoupled from the temporary increase in the charitable contribution deduction limit for qualified charitable contributions allowed under section 170 of the Code.

Section 2205 of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) amended section 170 of the Code to temporarily increase the charitable deduction limit for qualified contributions from a maximum of 60% of an individual’s AGI to 100% of AGI. For purposes of the charitable contribution deduction allowed under [G.S. § 105-153.5\(a\)\(2\)a](#), North Carolina adopted the Code as of January 1, 2020, which excludes the CARES Act. Consequently, an individual who claims North Carolina itemized deductions for tax year 2020 may only deduct qualified contributions up to 60% of the individual’s AGI.

For taxable years beginning on or after January 1, 2021, a taxpayer may only carry forward the charitable contributions from taxable year 2020 that exceed the applicable percentage limitation for the 2020 taxable year allowed under [G.S. § 105-153.5\(a\)\(2\)a](#).

**c. Medical and Dental Expenses.**

[G.S. § 105-153.5\(a\)\(2\)\(c\)](#) provides that an individual is allowed a North Carolina itemized deduction for medical and dental expenses for the amount allowed as a deduction under section 213 of the Code for that taxable year.

**d. Claim of Right Deduction.**

Under the federal “Claim of Right” Doctrine, a taxpayer who receives income under a claim of right and without restriction on the use or disposition of the income is taxed on that income in the year of receipt even though the right to retain the income is not yet fixed or the taxpayer may later be required to return it.

Under federal law, if a taxpayer is required to repay an amount previously included in the federal return in an earlier year, the taxpayer may be able to deduct the amount repaid or take a tax credit. The amount of the repayment determines the options available to the taxpayer. For further guidance, see federal Publication 525.

For North Carolina tax purposes, a taxpayer is allowed a deduction for the repayment to the extent the repayment is not deducted in arriving at the taxpayer's adjusted gross income in the current taxable year. If the repayment is more than \$3,000, the deduction is the amount of the repayment. If the repayment is \$3,000 or less, the deduction is the amount of repayment less 2% of adjusted gross income.

For information on how to compute the claim of right deduction, see "Repayment of Claim of Right Income" and "Repayment of Claim of Right Worksheet" located in the North Carolina Individual Income Tax Instructions ([Form D-401](#)).

No deduction is allowed if the taxpayer calculates the federal income tax in the year of repayment under the provisions of section 1341(a)(5) of the Code. In that case, a taxpayer will recover the tax previously paid on the repaid income under [G.S. § 105-266.2](#). For more information on the claim of right income credit, see [Claim of Right Income Credit](#).

*Reference:* [G.S. § 105-153.5\(a\)\(2\)](#); [Session Law 2020-58](#).

## V. Nonresident and Part-Year Residents

### 1. Definition of Resident

[G.S. § 105-153.3\(15\)](#) defines a resident as “an individual who is domiciled in this State at any time during the taxable year or who resides in this State during the taxable year for other than a temporary or transitory purpose.”

In the absence of convincing proof to the contrary, an individual who is present within North Carolina for more than 183 days during the taxable year is presumed to be a resident for income tax purposes, but the absence of an individual from the State for more than 183 days raises no presumption that the individual is not a resident.

A resident who moves from the State during a taxable year is considered a resident of North Carolina until the individual has both established a definite domicile elsewhere and abandoned any domicile in North Carolina. A taxpayer may have several places of abode in a year, but at no time can an individual have more than one domicile. A mere intent or desire to make a change in domicile is not enough; voluntary and positive action must be taken. The fact of marriage does not raise any presumption as to domicile or residence.

Listed below are some of the factors to be considered in determining the legal residence of an individual for income tax purposes. As implied by the list of factors below, an individual's legal state of residence is reflected more by the routine events of life rather than events such as voting or obtaining a driver's license which may occur every four to eight years.

1. Place of birth of the taxpayer, the taxpayer's spouse, and the taxpayer's children.
2. Permanent residence of the taxpayer's parents.
3. Family connections and close friends.
4. Address used for federal tax returns, military purposes, passports, driver's license, vehicle registrations, insurance policies, professional licenses or certificates, subscriptions for newspapers, magazines, and other publications, and monthly statements for credit cards, utilities, bank accounts, loans, insurance, or any other bill or item that requires a response.
5. Civic ties, such as church membership, club membership, or lodge membership.
6. Professional ties, such as licensure by a licensing agency or membership in a business association.
7. Payment of state income taxes.

8. Place of employment or, if self-employed, place where business is conducted.
9. Location of healthcare providers, such as doctors, dentists, veterinarians, and pharmacists.
10. Voter registration and ballots cast, whether in person or by absentee ballot.
11. Occasional visits or spending one's leave "at home" if a member of the armed services.
12. Ownership of a home, insuring a home as a primary residence, or deferring gain on the sale of a home as a primary residence.
13. Location of pets.
14. Attendance of the taxpayer or the taxpayer's children at State supported colleges or universities on a basis of residence—taking advantage of lower tuition fees.
15. Location of activities for everyday "hometown" living, such as grocery shopping, haircuts, video rentals, dry cleaning, fueling vehicles, and automated banking transactions.
16. Utility usage, including electricity, gas, telecommunications, and cable television.

Listed below are some of the factors to consider in determining when residency may have changed:

1. Selling a house and buying a new one.
2. Directing U.S. Postal Service to forward mail to a new address.
3. Transferring family medical records to a new health care provider.
4. Notifying senders of statements, bills, subscriptions, and similar items of new address.
5. Registering a vehicle in a new jurisdiction.
6. Transferring memberships for church, health club, lodge, or similar activity.
7. Applying for professional certifications in a jurisdiction.

A legal resident of North Carolina serving in the United States Armed Forces is liable for North Carolina income tax and North Carolina income tax should be withheld from military pay whether the individual is stationed in this State or in some other state or country.

An individual who enters military service while a resident of North Carolina is presumed to be a resident of this State for income tax purposes. Residency in this State is not abandoned until a definite residence is established elsewhere. To change residency, the servicemember must not only be present in the new location with the intention of making the new location the servicemember's domicile, but must factually establish that the servicemember has done so.

*Reference:* [G.S. § 105-153.4\(b\)](#); [17 NCAC 06B .3901](#).

## **2. Definition of a Nonresident**

[G.S. § 105-153.3\(11\)](#) defines a “nonresident individual” as “an individual who is not a resident of [North Carolina].” The term includes an individual:

- a. Who resides in North Carolina for a temporary or transitory purpose and is, in fact, a domiciliary resident of another state or country; or
- b. Who does not reside in North Carolina but has income from sources within North Carolina and is, in fact, a domiciliary resident of another state or country.

## **3. Servicemembers and Military Spouses**

### **a. Servicemembers**

Under the Servicemember's Civil Relief Act, a member of the Armed Services who is a legal resident of another state stationed in North Carolina by virtue of military orders is not subject to North Carolina income tax on service pay but other income from employment, a business, or tangible property in North Carolina is subject to North Carolina income tax.

For more information, see [Active Military](#).

*Reference:* [17 NCAC 06B .3902](#).

### **b. Military Spouses**

The Servicemembers Civil Relief Act provides that a spouse shall neither lose nor acquire domicile or residence in a state when the spouse is present in the state solely to be with the servicemember in compliance with the servicemember's military orders if the residence or domicile is the same for both the servicemember and the spouse.

The income earned for services performed in North Carolina by a spouse of a servicemember who is legally domiciled in a state other than North Carolina is not subject to North Carolina income tax if:

- (1) The servicemember is present in North Carolina in compliance with military orders,
- (2) The spouse is in North Carolina solely to be with the servicemember, and

(3) The spouse is domiciled in the same state as the servicemember.

All three of the conditions must be met to qualify for the exemption. For tax years beginning on or after January 1, 2018, the Veterans Benefits and Transition Act of 2018 amended the Servicemembers Civil Relief Act to allow the spouse of a servicemember to elect to use the same residence as the servicemember for state tax purposes. A spouse making this election will be considered to be domiciled in the same state as the servicemember. Note that the first two conditions must also be met in order for the spouse to qualify for the exemption.

There is no presumption as to the residence of a spouse of a member of the armed forces because of marriage. Legal residence will be determined based on the facts in each case.

**Example 1:** Servicemember and spouse were married in 2014 and are currently domiciled in Florida. Servicemember is stationed in North Carolina in June 2019. Spouse moves to North Carolina in June 2019 solely to be with servicemember. Spouse is employed and earns wages in North Carolina during 2019.

Spouse's wages are not subject to North Carolina tax for tax year 2019 because the servicemember is present in North Carolina in compliance with military orders, the spouse is in North Carolina solely to be with the servicemember, and the spouse is domiciled in the same state as the servicemember.

**Example 2:** Servicemember and spouse were married in 2014. Servicemember is domiciled in Florida, spouse is domiciled in Texas. Servicemember is stationed in North Carolina in January of 2019. Spouse moves to North Carolina in January 2019 solely to be with servicemember. Spouse is employed and earns wages in North Carolina during 2019. Spouse elects to use the same residence as the servicemember (Florida) for state tax purposes.

Spouse's wages are not subject to North Carolina tax for tax year 2019 because the servicemember is present in North Carolina in compliance with military orders, the spouse is in North Carolina solely to be with the servicemember, and the spouse has elected to be domiciled in the same state as the servicemember.

**Example 3:** Servicemember and spouse were married in 2014. Servicemember is domiciled in Florida, spouse is domiciled in Texas. Servicemember is stationed in North Carolina in January of 2017. Spouse moves to North Carolina in January 2017 solely to be with servicemember. Spouse is employed and earns wages in North Carolina from 2017 to 2019. Spouse elects to use the same residence as the servicemember (Florida) for state tax purposes.

For tax years 2018 and 2019, spouse's wages are not subject to North Carolina tax because the servicemember is present in North Carolina in compliance with military orders, the spouse is in North Carolina solely to be with the servicemember, and the spouse is domiciled in the same state as the servicemember due to the residency election. Because the residency election is only valid for tax years beginning on or after January 1, 2018, spouse's wages are subject to North



Carolina tax during 2017 because the spouse was not domiciled in the same state as the servicemember.

**Example 4:** Servicemember is domiciled in Florida and is stationed in North Carolina in July 2018. Spouse is domiciled in North Carolina. Spouse and servicemember meet in North Carolina in August 2018 and are married in October 2019. Spouse is employed and earns wages in North Carolina in 2018 and 2019. Spouse elects to use the same residence as the servicemember (Florida) for state tax purposes.

For tax year 2019, spouse's wages are subject to North Carolina tax because spouse is not in North Carolina solely to be with the servicemember. Note that while spouse's wages are subject to North Carolina tax, certain intangible income of the spouse may not be subject to North Carolina tax because spouse elected to use Florida as spouse's state of residence.

*Reference:* [17 NCAC 06B .3902](#).

#### **4. Part-Year Resident**

An individual who moves their domicile (legal residence) into or out of North Carolina during the tax year is a part-year resident.

*Reference:* [G.S. § 105-153.4\(c\)](#); [17 NCAC 06B .3903](#).

#### **5. Taxable Income of Nonresidents**

The taxable income of a nonresident subject to North Carolina income tax is determined by first calculating federal adjusted gross income as calculated under the Internal Revenue Code, adjusted as provided under [G.S. § 105-153.5](#) and [G.S. § 105-153.6](#). The result is multiplied by the percentage obtained when dividing the portion of total federal gross income derived from North Carolina sources, as adjusted, by the total federal gross income, as adjusted. Importantly, the percentage may be over 100% if a taxpayer's North Carolina sourced income is greater than the taxpayer's total income from all sources

**Note:** Only those North Carolina adjustments relating to a taxpayer's gross income should be included when determining the taxpayer's proration percentage. See [Schedule PN](#) and [Schedule PN-1](#) for additional information.

#### **6. Taxable Income of Part-Year Residents**

The taxable income of a part-year resident subject to North Carolina income tax is determined by first calculating federal adjusted gross income as calculated under the Internal Revenue Code, adjusted as provided under [G.S. § 105-153.5](#) and [G.S. § 105-153.6](#). The result is multiplied by the percentage obtained when dividing the portion of total federal gross income received from all sources during the period the individual was a resident of North Carolina, plus any income received from North Carolina sources while a nonresident, as adjusted, by the

total federal gross income, as adjusted. Importantly, the percentage may be over 100% if a taxpayer's North Carolina sourced income is greater than the taxpayer's total income from all sources.

If an individual has income from sources within another state or country while a resident of North Carolina and the other state or country taxes the individual on such income, the individual may be eligible to claim a tax credit for tax paid to the other state or country on the North Carolina income tax return.

**Note:** Only those North Carolina adjustments relating to a taxpayer's gross income should be included when determining the taxpayer's proration percentage. See [Schedule PN](#) and [Schedule PN-1](#) for additional information.

*Reference:* [G.S. § 105-153.4](#); [17 NCAC 06B .3904](#).

## **7. Nonresident Members of Professional Athletic Teams**

To determine the portion of an athlete's compensation for services rendered as a member of a professional athletic team during the taxable year that is considered North Carolina source income and included in the numerator of the fraction determined under [G.S. § 105-153.4\(b\)](#), the nonresident member of a professional athletic team multiplies the amount of total compensation for services rendered as a member of a professional athletic team during the taxable year by a fraction. The numerator of the fraction is the number of duty days spent in North Carolina rendering services for the team in any manner during the taxable year. The denominator is the total number of duty days spent both within and outside North Carolina during the taxable year.

Travel days that do not involve either a game, practice, team meeting, promotional caravan or other similar team activity are not considered duty days spent in North Carolina and compensation for those days is not included in the numerator of the fraction determined under [G.S. § 105-153.4\(b\)](#). However, such travel days are considered duty days spent within and outside North Carolina and compensation for those days is included in the denominator of the fraction determined under [G.S. § 105-153.4\(b\)](#).

Where the method of apportioning and allocating the compensation as described above produces substantially incorrect results, the Secretary of Revenue may require the member of a professional athletic team to apportion and allocate the compensation under another method prescribed by the Secretary as long as the prescribed method better reflects the compensation received for services performed in North Carolina. A nonresident member of a professional athletic team may request an alternative method to apportion and allocate the compensation, demonstrating that the method provided under this section produces substantially incorrect results. If the Secretary approves the alternative method, a copy of the Secretary's written approval must be included with the North Carolina income tax return filed by the nonresident member.

In determining the North Carolina source income of a nonresident member of a professional athletic team, the following definitions apply:

- a. The term “professional athletic team” includes, but is not limited to, any professional baseball, basketball, football, soccer, or hockey team.
- b. The term “member of a professional athletic team” includes those employees who are active players, players on the disabled list and any other persons required to travel and who do travel with and perform services on behalf of a professional athletic team on a regular basis. This includes, but is not limited to, coaches, managers and trainers.
- c. The term “duty days” means all days during the taxable year from the beginning of the professional athletic team’s official preseason training period through the last game in which the team competes or is scheduled to compete.

Duty days also include days on which a member of a professional athletic team renders a service for a team on a date that does not fall within the aforementioned period. Such services include participation in instructional leagues, the “Pro Bowl,” or promotional caravans. This includes days during the member’s off-season where the member conducts training activities at the facilities of the team.

Duty days include game days, practice days, days spent at team meetings, promotional caravans and preseason training camps, and days served with the team through all post-season games in which the team competes or is scheduled to compete.

Duty days for any person who joins a team during the season begins on the day the person joins the team, and for any person who leaves a team ends on the day the person leaves the team. Where a person switches teams during the taxable year, a separate duty day calculation will be made for the period the person was with each team.

Days for which a member of a professional athletic team is not compensated and is not rendering services for the team in any manner, including days when the person has been suspended without pay and prohibited from performing any services for the team, are not treated as duty days.

Days for which a player is on the disabled list are presumed not to be duty days spent in North Carolina. However, the days are considered to be included in total duty days spent within and without North Carolina.

- d. The term “total compensation for services rendered as a member of a professional athletic team” means the total compensation received during the taxable year for services rendered:
  - (1) From the beginning of the official preseason training period through the last game in which the team competes or is scheduled to compete during that taxable year; and

- (2) For an event during the taxable year which occurs on a date that does not fall within the aforementioned period such as participation in instructional leagues, the “Pro Bowl” or promotional “caravans.”

The compensation includes, but is not limited to, salaries, wages, bonuses, and any other type of compensation identified in Internal Revenue Code section 61 and its regulations and paid during the taxable year for services performed in that year. Such compensation does not include strike benefits, severance pay, termination pay, contract or option year buy-out payments, expansion or relocation payments, or any other payments not related to services rendered to the team.

- e. “Bonuses” are included in “total compensation for services rendered as a member of a professional athletic team” and subject to allocation if they are:

- (1) Earned as a result of play, such as performance bonuses, during the season, including bonuses paid for championship, playoff or “bowl” games played by a team, or for selection to all-star league or other honorary positions; and

- (2) Paid for signing a contract, unless all of the following conditions are met:

- a. the payment of the signing bonus is not conditional upon the signee playing any games for the team, or performing any subsequent services for the team, or even making the team;
- b. the signing bonus is payable separately from the salary and any other compensation; and
- c. the signing bonus is nonrefundable.

For more information on withholding requirements of professional athletic teams, see [Professional Athletes](#).

*Reference:* [17 NCAC 06B .3905](#).

## **8. Severance Wages & Unemployment Compensation**

### **a. Severance Wages**

Severance wages may be granted by a taxpayer’s employer as a result of the taxpayer’s permanent, involuntary termination from employment. Because severance wages are paid to a taxpayer after a taxpayer’s employment ends, they do not constitute compensation for services performed. Consequently, severance wages paid to a nonresident of North Carolina are not taxable by North Carolina even if paid in connection with a job in North

Carolina. In addition, severance wages paid to a North Carolina resident are taxable by North Carolina even if paid in connection with a job outside of North Carolina.

**Example 1.** Taxpayer is a North Carolina resident and employed at a North Carolina business. Taxpayer is laid off in October 2018. In November 2018 Taxpayer changes his domicile to Georgia. Taxpayer receives severance pay from his previous employer beginning February 2019.

Taxpayer's severance pay is not subject to North Carolina tax because Taxpayer is no longer a resident of North Carolina when the payments are made.

**Example 2.** Taxpayer is a Virginia resident and employed at a Virginia business. Taxpayer is laid off in June 2018. In July 2018 Taxpayer changes her domicile to North Carolina. Taxpayer receives severance pay from her previous employer beginning February 2019.

Taxpayer's severance pay is subject to North Carolina tax because Taxpayer is a resident of North Carolina when the payments are made.

#### **b. Unemployment Compensation**

Unemployment insurance provides temporary assistance to individuals who have become unemployed due to no fault of their own. Unemployment compensation includes state unemployment insurance benefits and benefits paid by a state or the District of Columbia from the Federal Unemployment Trust Fund. It also includes railroad unemployment compensation benefits, but not worker's compensation. Unemployment compensation is included in adjusted gross income. Unemployment compensation received by a North Carolina resident is taxable by North Carolina regardless of the state where the taxpayer's former employer paid unemployment taxes and regardless of the location of the taxpayer's previous place of employment.

**Example.** Taxpayer is a North Carolina resident and was employed at a South Carolina business. Taxpayer is laid off in January 2019. During February and March 2019, Taxpayer receives unemployment compensation from the state of South Carolina while a North Carolina resident.

Taxpayer's unemployment compensation is subject to North Carolina tax because Taxpayer is a resident of North Carolina when the payments are made.

## VI. Bailey Settlement

As a result of the North Carolina Supreme Court’s decision in *Bailey v. State of North Carolina* and the settlement subsequently reached in that case, North Carolina may not tax retirement benefits received by a retiree (or by a beneficiary of a retiree) from qualifying State, local, or federal retirement systems if the retiree was vested in the retirement system as of August 12, 1989. For most government retirement systems, a person is vested if the person had five or more years of creditable service in a qualifying State, local or federal retirement system as of August 12, 1989. For certain retirement systems, the vesting period is less.

### 1. Qualifying State or Local Retirement System

The following retirement systems were designated as a North Carolina State or local governmental retirement system:

System	Law Creating the System
North Carolina Teachers’ and State Employees’ Retirement System (TSERS)	<a href="#">G.S. § 135, Article 1</a>
Optional Retirement Program available to administrators and faculty of the University of North Carolina system in lieu of TSERS	<a href="#">G.S. § 135-5.1</a>
North Carolina Local Governmental Employees’ Retirement System	<a href="#">G.S. § 128, Article 3</a>
North Carolina Consolidated Judicial Retirement System	<a href="#">G.S. § 135, Article 4</a>
North Carolina Legislative Retirement System	<a href="#">G.S. § 120, Article 1A</a>
North Carolina Disability Income Plan (both short-term and long-term disability benefits)	<a href="#">G.S. § 135, Article 6</a>
North Carolina Supplemental Retirement Income Plan	<a href="#">G.S. § 135, Article 5</a>
North Carolina Supplemental Retirement Income Plan for State Law Enforcement Officers	<a href="#">G.S. § 143-166.30(d)</a>
North Carolina Deferred Compensation Plan	<a href="#">G.S. § 143B-426.24</a>
North Carolina National Guard Pension Fund	<a href="#">G.S. § 127A-40</a>
North Carolina Sheriffs’ Supplemental Pension Fund	<a href="#">G.S. § 143, Article 12H</a>
North Carolina Registers of Deeds’ Supplemental Pension Fund	<a href="#">G.S. § 161, Article 3</a>
North Carolina Supplemental Retirement Plan for Local Governmental Law Enforcement Officers	<a href="#">G.S. § 143-166.50(e)</a>

Separate Insurance Benefits Plan for State and Local Governmental Law Enforcement Officers	<a href="#">G.S. § 143-166.60</a>
North Carolina Firemen’s and Rescue Squad Workers’ Pension Fund	<a href="#">G.S. § 58, Article 86</a>
Charlotte Firefighters’ Retirement System	Session Laws 1947, Chapter 926, § 6(c)
Firemen’s Supplemental Fund of Hickory	Session Laws 1971, Chapter 65
Winston-Salem Police Officers’ Retirement System	Session Laws 1939, Chapter 296
New Hanover County School Employees’ 1979 Retirement Plan	Session Laws 1979, Chapter 1307

No local government optional contribution plans, similar to the State’s Supplemental Retirement Income Plan and Deferred Compensation Plan, were afforded tax exemption prior to August 12, 1989. Therefore, retirement benefits from local government optional contribution plans (such as local government 457 plans) are not subject to future tax exemption.

Teachers and other employees of North Carolina’s public schools have the option of contributing to optional contribution plans established pursuant to section 403(b) of the Code. Distributions from these plans may not be excluded from taxable income under the settlement.

The “special separation allowance” paid to retired law enforcement officers pursuant to [G.S. § 143-166.41](#) and reported on federal Form W-2 does not qualify for exclusion under *Bailey*.

## 2. Vesting Period for Qualifying State or Local Retirement Systems

The general rule is that a participant in a qualifying State or local retirement system is vested if the participant had five or more years of creditable service as of August 12, 1989. However, the general rule does not apply to qualifying optional contribution plans or to certain other qualifying plans.

Participants in the State’s Supplemental Retirement Income Plan (Internal Revenue Code § 401(k)) or the State’s Deferred Compensation Plan (Code § 457) are vested in the plan as of August 12, 1989, if they contributed or contracted to contribute to the plan by August 12, 1989. If the participant contributed any money to a plan before August 12, 1989, all future withdrawals from that plan are excludable from tax. Contributions to one plan prior to August 12, 1989, do not qualify contributions to the other plan as vested. For example, if a State employee began contributing to the §401(k) plan in June 1989, and to the §457 plan in October 1989, the employee is vested only in the §401(k) plan. Participants in the State’s Supplemental Retirement Income Plan or the State’s Deferred Compensation Plan may have chosen an annuity as an investment option. In some cases, they receive the annuity payments and the subsequent tax information statement from the annuity company instead of the plan administrator. These amounts also qualify for future tax exemption if the retiree was vested.

Participants in the North Carolina Firemen's and Rescue Squad Workers' Pension Fund are vested as of August 12, 1989, only if the individual had both five years of service and had paid five years of contributions to the plan by August 12, 1989. Sheriffs receiving benefits from the North Carolina Sheriffs' Supplemental Pension Fund and Registers of Deeds receiving benefits from the North Carolina Registers of Deeds' Supplemental Pension Fund are vested as of August 12, 1989, only if the sheriff or the register of deeds (not a deputy or assistant) had five years of service as a sheriff or a register of deeds and five years of participation in the Local Governmental Employees' Retirement System (or equivalent local plan) by August 12, 1989.

An employee in a qualifying State or local governmental retirement system who was vested prior to August 12, 1989, and who leaves employment remains vested if the employee later returns to work, provided the employee did not withdraw the employee's contributions to the retirement system. If the employee withdrew the contributions, the employee is no longer vested in the retirement system, even if the employee subsequently buys back the service time, unless the employee returned to employment in time to become vested again before August 12, 1989.

### **3. Qualifying Federal Retirement Systems**

The following retirement systems were designated as a federal governmental retirement system:

- Federal Civil Service Retirement System
- Federal Employees' Retirement System
- Lighthouse Retirement System
- Thrift Savings Plan
- Foreign Service Retirement and Disability System and Pension System
- Military Retirement System
- Coast Guard Retirement System
- Central Intelligence Agency Retirement System
- Commissioned Corps of the Public Health Service Retirement System
- Comptrollers' General Retirement Plan
- Judicial Plans & Pay for Federal Judges Treated as Retirement Pay by Federal Law, including:
  - Judicial Retirement System
  - Judicial Survivors' Annuities System
  - Court of Federal Claims Judges' Retirement System
  - Court of Veterans Appeals Judges' Retirement Plan
  - Judicial Officers' Retirement System (for Bankruptcy Judges and Magistrates)
  - United States Tax Court Retirement Plan
  - United States Tax Court Survivors' Annuity Plan
  - Retirement Plans for District Court Judges for the Northern Mariana Islands, the Virgin Islands, and Guam
  - Court of Appeals for the Armed Forces Judges Retirement System



- National Oceanic and Atmospheric Administration Retirement System
- Tennessee Valley Authority Retirement System and TVA Savings and Deferral Retirement Plan
- Financial Institutions Retirement Fund (Office of Thrift Supervision Employees)
- Federal Home Loan Bank Board Retirement Systems
- Federal Home Loan Mortgage Corporation Plan
- Federal Reserve Employees Retirement Plans and Thrift Plan
- Nonappropriated fund plans, including:
  - Retirement Annuity Plan for Employees of Army and Air Force Exchange Service
  - Supplemental Deferred Compensation Plan for Members of the Executive Management Program (Army and Air Force Exchange Service)
  - Nonappropriated Fund Retirement Plan for Civilian Employees
  - United States Army Nonappropriated Fund Retirement Plan
  - Retirement Plan for Civilian Employees of United States Marine Corps Morale, Welfare, and Recreation Activities and Miscellaneous Nonappropriated Fund Instrumentalities
  - Navy Exchange Service Command Retirement Plan
  - Navy Nonappropriated Fund Retirement Plan for Employees of Civilian Morale, Welfare, and Recreation Activities
  - Norfolk Naval Shipyard Pension Plan
  - Retirement Savings Plan and Trust for Employees of the Army and Air Force Exchange Service
  - Coast Guard Nonappropriated Fund Retirement Plan
- District of Columbia Police Officers and Fire Fighters' Retirement Fund and Related Funds (including payments to Secret Service and U.S. Park Police covered by the Fund)
- District of Columbia Teachers' Retirement Fund and Related Funds
- District of Columbia Judges' Retirement Fund and Related Funds
- Uniformed Services University of the Health Sciences Plan
- Smithsonian Institution Defined Contribution Retirement Plan
- USDA Graduate School Plan

#### **4. Vesting Period for Qualifying Federal Retirement Systems**

Generally, participants in the qualifying federal retirement systems listed above, including military retirees, are vested for purposes of the settlement if they had five or more years of creditable service as of August 12, 1989. The general rule, however, does not apply to the Thrift Savings Plan.

The Thrift Savings Plan has both an employee and an employer component. The employee component is similar to the State's § 401(k) and § 457 plans and allows the employee to voluntarily contribute to the Plan. The employee is vested in the employee component if the employee first made a contribution to the plan prior to August 12, 1989. The employer component includes both contributions by the employer of a fixed percentage of the employee's salary and contributions by the employer that match the employee's voluntary contributions. The employee is also vested in the employer matching contributions if the

employer first made a matching contribution prior to August 12, 1989. An employee is vested in the employer fixed component only if the employee had three years of service (two years of service for certain highly ranked employees) as of August 12, 1989. One exception to the three-year rule is that an employee who died prior to completing the mandatory three years is still considered vested if the date of death was on or before August 12, 1989.

As explained above, it is possible for a participant in the Federal Thrift Savings Plan to be vested as of August 12, 1989, in some components of the plan while at the same time not being vested in other components. The annual tax information statement (federal Form 1099-R) does not distinguish between the various components when reporting the amount distributed during the year; therefore, the recipient cannot readily determine the amount to exclude from North Carolina income tax. When a participant in the plan ceases employment, the recipient should request a statement that identifies the cash balances in the various components. To determine the proper amount to exclude, the recipient should multiply the annual distribution by a fraction, the numerator of which is the balance of the components in which the recipient is vested as of August 12, 1989. The denominator of the fraction is the total cash balance of all components. That same fraction will be used for each year the recipient receives distributions from the plan.

## **5. Rollover Distributions with Respect to Bailey Retirement Plans – General**

The Economic Growth and Tax Relief Reconciliation Act of 2001 made numerous changes with respect to pension portability. All distributions from a qualifying *Bailey* retirement account in which the employee/retiree was “vested” as of August 12, 1989, are exempt from State income tax regardless of the source of the funds contained in the account. Conversely, qualifying tax-exempt *Bailey* benefits rolled over into another retirement plan lose their character and would not be exempt upon distribution from the other plan unless that plan is a qualifying *Bailey* retirement account in which the employee was vested as of August 12, 1989.

For more information, see [Departmental Directive PD-04-1](#). For special rules regarding the Optional Retirement Program, see [Departmental Directive PD-00-1](#).

## **6. Bailey Retirement Plan Rollover Distribution to a Roth Account**

Effective January 1, 2008, distributions from qualified retirement plans could be rolled over into Roth IRAs. Qualified retirement plans include 401(k), 403(b), and 457 plans. A rollover distribution to a Roth account is generally taxable at the time of the rollover and the subsequent distributions from the Roth account are generally not taxable. If the rollover to a Roth account is from a qualifying tax-exempt *Bailey* retirement account, the rollover distribution is exempt from State income tax and deductible on the State return to the extent the rollover distribution was included as income on the taxpayer’s federal income tax return.

For more information, see [Departmental Directive PD-14-1](#).

## **7. Transfers between Supplemental Retirement Plans and North Carolina State or Local Retirement Systems**

Session Laws [2007-384](#) and [2010-124](#), enacted legislation that provided for a Special Retirement Allowance for Law Enforcement Officers and other North Carolina state and local government employees. This Special Retirement Allowance provided these employees or retirees the option to transfer accumulated contributions from their Supplemental Retirement Income Plan or Deferred Compensation Plan to the Teachers' and State Employees' Retirement System (TSERS) and/or the Local Governmental Employees' Retirement System (LGERS). The law specifically states that these transfers do not cause the contributions to lose their status as being either qualifying tax-exempt *Bailey* benefits or non-qualifying benefits. The Teachers' and State Employees' Retirement System is responsible for determining the taxable amount, if any, and will report this information to the retiree.

## **8. Benefits from Other Retirement Plans**

Effective for taxable years beginning on or after January 1, 2014, there are no deductions available for distributions from private retirement plans or government retirement plans that do not qualify as tax-exempt *Bailey* benefits.

## VII. Partnerships

### 1. General

The starting point for preparing the North Carolina partnership income tax return, [Form D-403](#), is the partnership's total income or loss. If the partnership provides a copy of its federal partnership income tax return (Form 1065) with its North Carolina partnership return, the partnership can enter the sum of lines 1 through 11 of Schedule K, Form 1065 as total income or loss on Form D-403, Part 1, line 1 in lieu of completing Form D-403, Part 6. The additions and deductions required for individuals under [G. S. § 105-153.5](#) and [G.S. § 105-153.6](#) apply to partnerships.

**Note:** Only the adjustments allowed by North Carolina law can be claimed on the partnership return. Deductions reported on Federal Form 1065, Schedule K, Lines 12 and 13 cannot be claimed on the North Carolina partnership return.

The partnership income tax return shall include the names and addresses of the persons entitled to share in the net income of the partnership and shall be signed by the managing partner and the individual preparing the return. Income from an intangible source which is received in the course of doing business in this State so as to have a taxable situs here (including such income which is included in the distributive share of partnership income, whether distributed or not) is included in the numerator of the fraction used in determining the portion of income that is taxable to North Carolina by a nonresident.

*Reference:* [G.S. § 105-154](#); [17 NCAC 06B .3501](#).

### 2. Time and Place for Filing a Partnership Return

A North Carolina partnership return must be filed by every partnership doing business in North Carolina if a federal partnership return was required to be filed. The return of a partnership on a calendar year basis is due on or before April 15 following the close of the calendar year. If on a fiscal year basis, the return must be filed on or before the 15th day of the fourth month following the close of the fiscal year. For information on when a document is considered timely filed, see [Departmental Directive TA-16-1](#) and [Departmental Directive TA-18-1](#).

If the partnership return cannot be filed by the due date, the partnership may apply for an automatic six-month extension of time to file the return. A partnership that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina income tax return. To receive an automatic State extension, the partnership must certify on the North Carolina tax return that the partnership was granted an automatic federal extension. If the partnership is not granted an automatic federal extension, the partnership must file [Form D-410P](#), Application for Extension for Filing Partnership, Estate, or Trust Tax Return, by the original due date of the return in order to receive an extension for North Carolina purposes.

*Reference:* [G.S. § 105-155](#); [17 NCAC 06B .3503](#).

### **3. Refund Requests for Tax Paid on Behalf of Nonresident Partners**

The manager of a partnership may not request a refund of an overpayment made on behalf of a nonresident owner or partner if the manager of the business has already filed the partnership return and paid the tax due. The nonresident owner or partner may, on its own income tax return, request a refund of an overpayment made on its behalf by the manager of the partnership within the provisions of [G.S. § 105-241.6](#). A nonresident individual partner who is not required to file a North Carolina individual income tax return pursuant to the provisions [17 NCAC 06B .3513](#) must file a North Carolina individual income tax return in order to receive a refund of tax paid on the nonresident partner's behalf by the manager of the partnership.

*Reference:* [G.S. § 105-154](#)

### **4. Electronic Filing**

The North Carolina Department of Revenue participates in the Federal/State eFile program, the fastest, safest, and most accurate way to file partnership income tax returns. The eFile program, the number one Department-recommended method for filing and paying income taxes, allows partnerships to file their federal and State tax returns in a single electronic transmission, or to file their State returns separate from their federal returns. It also allows filing of extensions and bank payments; and features acknowledgment and confirmation of receipt of tax forms.

Tax practitioners and taxpayers must eFile using Internal Revenue Service (IRS)-approved and Department-approved, commercially developed, software products; please visit [eFile for Businesses](#) to access a list of approved software developers and products. Using approved software, taxpayers can self-prepare their federal and State returns or use the services of a professional tax practitioner. The availability and functionality for extensions and payments vary by software developer; therefore, tax practitioners and taxpayers should confirm product availability when selecting a developer.

To participate in the Federal/State eFile program, a tax practitioner must have previously completed an IRS Form 8633, "Application to Participate in the eFile Program." To participate in State eFile, the practitioner must have been accepted into the Federal program and have received an Electronic Filing Identification Number (EFIN) from the IRS. The Department has access to the Federal Applicant Database that enables the Department to reference pertinent information regarding the tax practitioner.

### **5. Schedule NC K-1**

[Schedule NC K-1](#) is used by the partnership to report each partner's distributive share of the partnership's income, adjustments, tax credits, tax paid, etc. The NC K-1 must reflect the net North Carolina tax paid by the partnership on behalf of the partner. A partner's distributive share of partnership income includes any guaranteed payments made to the partner. The partnership must provide a completed Schedule NC K-1, or other documents containing all of

the information that would be reported on Schedule NC K-1, to each person who was a partner in the partnership at any time during the year. This schedule must be provided to each partner on or before the day on which the partnership return is required to be filed. When reporting the distributive share of tax credits, a list of the amount and type of tax credits should be provided to each partner.

*Reference:* [G.S. § 105-154](#); [17 NCAC 06B .3503](#).

## 6. Penalties

The penalty for failure to file a partnership return on which tax is due by the due date is 5% of the net tax due for each month, or part of a month, the return is late. The maximum penalty is 25% of the unpaid tax. Net tax due is the amount of tax required to be shown on the return less any timely payments of the tax and allowable credits.

Pursuant to [G.S. § 105-236\(a\)\(10\)](#), the penalty for failure to file an informational return by the due date is \$50 per day, up to a maximum of \$1,000. This penalty applies to any partnership return filed after the due date, regardless of whether the return indicated tax due, an overpayment, or no tax due. For a partnership return on which tax is due, both the failure to file penalty of [G.S. § 105-236\(a\)\(3\)](#) and the informational return penalty under [G.S. § 105-236\(a\)\(10\)](#) may be assessed.

If a partnership does not pay the total amount of tax due on or before the original due date of the return, a late payment penalty of 10% of the tax shown due on the return less any timely payments of the tax and allowable credits is due. If the partnership has a valid extension of time for filing the return, a 10% late payment penalty will apply on the remaining balance due if the tax paid by the original due date is less than 90% of the total amount of tax due. In addition, penalties are provided by law for willful failure to file a return on time and for willful attempt to evade or defeat the tax. For more information, see [Penalties and Interest](#).

*Reference:* [17 NCAC 06B .3203](#).

## 7. Nonresident Partners

When an established business in North Carolina is owned by a partnership having one or more nonresident members, the managing partner is responsible for reporting the share of the income of each nonresident partner and is required to compute and pay the tax due on behalf of those partners. If the nonresident partner is a corporation, partnership, trust or estate, the managing partner is not required to pay the tax on that partner's share of the partnership income if the partner provides [Form NC-NPA](#), Nonresident Partner Affirmation. Otherwise, the managing partner is required to pay the tax on the nonresident partner's share.

Form NC-NPA affirms that the partner will pay the tax with its corporation, partnership, trust, or estate income tax return. The affirmation must be annually filed by the nonresident partner and submitted by the manager by the due date of the partnership return. The affirmation must be signed by the partner. An unsigned form is not considered valid. The signed affirmation

applies to the original return, any amended returns for that year, and any proposed assessments of additional tax for that year.

The tax rate is the same as the tax rate for individuals. See [Tax Rate Schedules](#).

Payment of the tax due by the managing partner on behalf of corporations, partnerships, trusts and estates that are partners does not relieve the partner from filing a North Carolina income tax return; however, credit for the tax paid by the managing partner may be claimed on the income tax return. Although a partnership may treat guaranteed payments to a partner for services or for use of capital as if they were paid to a person who is not a partner, that treatment is only for purposes of determining the partnership's gross income and deductible business expenses. For other tax purposes, guaranteed payments are treated as a partner's distributive share of ordinary income. In determining the allowable North Carolina deductions from income, do not include a partner's salary, interest on a partner's capital account, partner relocation and mortgage interest differential payments. These types of payments are treated as part of the partner's share of the partnership income.

For the purposes of [G.S. § 105-154\(d\)](#), a corporation or LLC is a nonresident of North Carolina if its commercial domicile is not in North Carolina and North Carolina is not its state of incorporation or organization. Commercial domicile means the principal place from which the trade or business of the partner is directed or managed. If the partner's address of record is outside of North Carolina, there is a presumption that the partner is not a North Carolina resident. This presumption may be overcome by evidence of the relevant facts and circumstances showing that the partner is domiciled in North Carolina.

A nonresident individual partner is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the nonresident's share of income from a partnership doing business in North Carolina and the manager of the partnership has reported the income of the nonresident partner, including any guaranteed payments made to the partner, and has paid the tax due for the nonresident individual partner. A nonresident individual partner may file an individual income tax return and claim credit for the tax paid by the manager of the partnership if the partner submits with the individual income tax return the [Schedule NC K-1](#) or other document from the partnership verifying that the partnership paid tax on behalf of the partner.

For more information regarding the calculation of tax due for nonresident partners, see [Departmental Directive PD-14-02](#).

**Publicly Traded Partnerships.** A publicly traded partnership as described in section 7704 of the Internal Revenue Code is required to file an information return only for those nonresident partners whose distributive share of the partnership net income for the tax year is more than \$500. The return should list the partner's name, address, taxpayer identification number, and the partner's share of income from the partnership for the tax year. A publicly traded partnership is not required to pay the tax on behalf of the nonresident partners.

*Reference:* [G.S. § 105-154](#); [S.L. 2020-58](#); [17 NCAC 06B .3513](#).

## **8. Disposition of Partner's Interest**

An interest in a partnership is intangible personal property. Nonresident partners do not include the gain from the sale of their interest in a partnership in the numerator of the fraction in determining North Carolina taxable income unless the sale of the partnership interest conveys title to specific partnership property. If a partnership owning an interest in another partnership sells its interest in that partnership, the nonresident partners do not include their distributive shares of the gain realized by the partnership from the sale of its partnership interest in the numerator unless the partnership selling its interest is carrying on a trade or business in this State.

Nonresident partners must include their distributive shares of the gains or losses from the sale or other disposition of the partnership's assets in the numerator of the fraction in determining North Carolina taxable income. If the sale of a partnership interest conveys title to specific partnership property instead of to a limited interest in the partnership, the transaction will be considered as a sale of partnership assets for purposes of determining North Carolina taxable income.

*Reference:* [17 NCAC 06B .3527.](#)

## **9. Part-Year Residents**

Part-year residents with distributive income from a partnership doing business in North Carolina and in one or more other states must prorate their shares of the partnership's income attributable and not attributable to North Carolina between their periods of residence and non-residence in accordance with the number of days in each period. The amount required to be included in the numerator of the fraction for determining taxable income is the taxpayer's share of partnership income determined for the period of residence plus the taxpayer's share of the partnership income attributable to North Carolina during the period of non-residence.

*Reference:* [G.S. § 105-153.4;](#) [17 NCAC 06B .3528.](#)

## **10. Estimated Income Tax**

A partnership is not required to pay estimated income tax. Resident individual partners who meet statutory requirements must pay estimated income tax on [Form NC-40](#), Individual Estimated Income Tax. Nonresident individual partners are not required to pay estimated tax on their distributive share of partnership income.

*Reference:* [17 NCAC 06B .3521.](#)

## **11. Interest Income Passed Through to Partners**

Although the interest income passed through to a partner in a partnership retains its same character as when received by the partnership, the expenses incurred in earning interest income are either deductible by the partnership and net interest income after expenses is reflected in



the partner's pro rata share of the income of the partnership or not deductible by the partnership and interest income before expenses is reflected in the partner's pro rata share of the income of the partnership.

Net interest income shall be reported if the activities are considered trade or business activities under federal law and interest income before expenses shall be reported if the activities are considered investment activities under federal law. If the activities are considered investment activities, the expenses incurred in earning that income shall be reported by the partnership to its partners as a separately stated item and shall be deducted by the partner to the extent allowable on the partner's income tax return.

For interest income subject to federal income tax and considered trade or business activities, the partner's federal gross income includes the net interest income after expenses incurred in earning the income. If that interest income is deductible from federal adjusted gross income pursuant to [G.S. § 105-153.5\(b\)](#), the individual partner shall deduct the net income on the North Carolina return. For interest income subject to federal income tax and considered investment activities, the partner's federal gross income includes the interest income before expenses incurred in earning the income. If that interest income is deductible from federal adjusted gross income pursuant to [G.S. § 105-153.5\(b\)](#), the individual partner shall deduct the income before expenses on the North Carolina return. No addition shall be made for the expenses incurred in earning that income to the extent those expenses are deductible by the individual partner in arriving at federal adjusted gross income.

Interest income not subject to federal income tax is not included in the partner's federal adjusted gross income. For interest income not subject to federal tax but required to be added to federal adjusted gross income pursuant to [G.S. § 105-153.5\(c\)](#), the individual partner shall add the total interest income on the North Carolina return. No deduction shall be made for expenses incurred in earning that income if the expenses are not deductible in arriving at federal adjusted gross income. In these cases, a partner must adjust federal adjusted gross income as required by [G.S. § 105-153.5 \(b\)](#) or [G.S. § 105-153.5\(c\)](#), for the net amount of interest attributable to the partnership.

*Reference:* [17 NCAC 06B .3529.](#)

## **12. Income Tax Credits of Partnerships**

A partnership may pass through to each of its partners the partner's distributive share of an income tax credit for which the partnership qualifies. Any dollar limit on the amount of a tax credit applies to the partnership as a whole instead of to the individual partners. The maximum dollar limits and other limitations that apply in determining the amount of tax credit available to a taxpayer apply to the same extent in determining the amount of tax credit for which the partnership qualifies, except the limitation that the tax credit cannot exceed the tax liability of the taxpayer.

*Reference:* [G.S. § 105-269.15.](#)

### **13. Limited Liability Companies**

The North Carolina Limited Liability Company Act ([Chapter 57D](#)) of the North Carolina General Statutes permits the organization and operation of limited liability companies. A limited liability company is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership. Limited liability companies are subject to State taxation according to their classification for federal income tax purposes; therefore, if a limited liability company is classified as a partnership for federal income tax purposes, the company and its members are subject to tax to the same extent as a partnership and its partners and is required to file a North Carolina partnership return.

A limited liability company may be organized by a single member by delivering executed articles of organization to the Secretary of State.

### **14. Foreign Partnerships**

North Carolina income tax is required to be withheld from compensation paid to foreign partnerships for certain personal services performed in North Carolina. For more information, see [Withholding from Non-Wage Compensation](#). If the partnership has a permanent place of business in North Carolina, no tax is required to be withheld if the partnership provides to the payer the partnership's address and taxpayer identification number.

Partnerships may claim credit on the partnership income tax return, [Form D-403](#), for the portion of the tax withheld attributable to nonresident partners on whose behalf the managing partner pays tax. The portion of the tax withheld attributable to resident partners or nonresident partners that have provided an affirmation to the managing partner (see [Nonresident Partners](#)) must be allocated to those partners on [Schedule NC K-1](#).

### **15. Investment Partnerships**

A partnership whose only activity is as an investment partnership is not considered to be doing business in North Carolina. An investment partnership is a partnership that is not a dealer in securities, as defined in section 475(c)(1) of the Internal Revenue Code, and that derives income exclusively from buying, holding, and selling securities for its own account. If any of the partnership's income consists of ordinary operating income whether from direct activities or flowing through from other partnerships, the partnership is not considered an investment partnership for North Carolina tax purposes.

An investment partnership is not required to file an income tax return in North Carolina or pay income tax to North Carolina on behalf of its nonresident partners.

*Reference:* [17 NCAC 06B .3503](#).

## VIII. S Corporations

### 1. General

An individual shareholder of an S corporation is required to take into account their pro rata share of an S corporation's net income in the manner provided under section 1366 of the Internal Revenue Code subject to certain adjustments.

*Reference:* [G.S. § 105-131](#); [G.S. § 105-131.1](#).

### 2. Resident Shareholder

Since 100% of the S corporation's income is included in a resident shareholder's federal adjusted gross income starting point, no adjustment because of doing business outside of North Carolina is required by a resident.

### 3. Nonresident Shareholders

A nonresident shareholder of an S corporation takes into account only their share of the S corporation's income attributable to North Carolina in the numerator of the fraction in determining that portion of adjusted gross income that is taxable to North Carolina. If an S corporation does business in North Carolina and one or more other states, the income attributable to North Carolina is determined by the same apportionment formula as used for other corporations.

All nonresident shareholders must include an agreement with the first S corporation return filed with North Carolina agreeing to be liable and subject to the laws of North Carolina for individual income tax purposes; otherwise, the S corporation becomes liable for the tax on the income attributable to such nonresident shareholders at the rate for individuals.

A nonresident shareholder in an S corporation may claim credit on the shareholder's North Carolina individual income tax return for the tax paid on their behalf by the S corporation to North Carolina on the shareholder's share of the S corporation income.

*Reference:* [G.S. §105-131.5](#); [G.S. § 105-131.7](#); [G.S. § 105-153.4](#); [17 NCAC 06B .4003](#).

### 4. Tax Credits

If part of the S corporation's income is earned within and taxed by another state or country, either to the individual or to the corporation, a resident shareholder is entitled to a tax credit on the individual income tax return for the amount of the tax paid to the other state or country. A shareholder claiming the tax credit must attach a schedule to the income tax return reflecting the total amount of tax paid to the other state or country by the S corporation and explaining how the shareholder's pro rata tax was determined. A separate tax credit must be calculated for each state or country to which the S corporation paid tax. Nonresident shareholders are not allowed credit for tax paid to another state or country.

A shareholder is subject to the individual adjustments under [G.S. § 105-153.5](#) and [G.S. § 105-153.6](#) rather than being subject to both individual and corporate income tax adjustments, regardless of the shareholder's residency status or whether the income is attributable to North Carolina.

*Reference:* [G.S. § 105-131.8](#); [17 NCAC 06B .4004](#).

## 5. Basis in Stock

Due to different tax treatment of an S corporation's income for State and federal purposes for taxable years beginning before January 1, 1989, a shareholder's basis in the stock of an S corporation for State tax purposes may be different than for federal tax purposes; thereby requiring adjustments in determining North Carolina taxable income upon receipt by the shareholder of distributions from the S corporation and upon disposition of the S corporation stock.

The initial basis of the stock in an S corporation to a nonresident of North Carolina is zero, and the nonresident shareholder is not taxed on distributions from the corporation and recognizes no income or loss upon disposition of the stock. A nonresident shareholder's basis in the S corporation stock is adjusted for the shareholder's pro rata share of the income or loss of the corporation.

A resident shareholder's initial basis in the stock of an S corporation is determined as of the later of the date the stock is acquired, the effective date of the S corporation election, or the date the shareholder became a resident of North Carolina. A resident shareholder's basis in the stock is increased by the shareholder's pro rata share of the corporation's income, subject to the adjustments required under [G.S. § 105-153.5](#) and [G.S. § 105-153.6](#), except for income exempt from federal or State income taxes and deductions for depletion in excess of the basis of the property being depleted. The basis is decreased by distributions to the extent deemed a return of basis; a pro rata share of the losses of the corporation as adjusted under [G.S. § 105-153.5](#) and [G.S. § 105-153.6](#); nondeductible expenses of the corporation; and the amount of the shareholder's deduction for depletion of oil and gas wells to the extent the deduction does not exceed the proportionate share of the adjusted basis of that property allocated to the shareholder. The adjustments to the basis do not apply to tax periods beginning prior to January 1, 1989.

The aggregate amount of losses taken into account by the shareholder of an S corporation may not exceed the combined adjusted basis of the shareholder's stock and indebtedness of the corporation to the shareholder.

**Example:** A is a resident of North Carolina and his share of the loss of an S corporation for the tax year 1989 is \$50,000. On January 1, 1989, A's basis in the S corporation stock for federal income tax purposes was \$110,000, comprised of \$40,000 initial cost plus his share of the undistributed income of the S corporation of \$70,000.

Since for federal tax purposes the loss does not exceed his basis, the \$50,000 is allowed as a deduction in computing federal taxable income. For State tax purposes, his basis is the \$40,000 initial cost since the prior year undistributed income is not included in his basis due to being for tax years prior to January 1, 1989. Therefore, the loss that A may take into account in determining his North Carolina taxable income is \$40,000 and he is required to adjust federal taxable income by \$10,000 (\$50,000 total loss less \$40,000 basis).

*Reference:* [G.S. § 105-131.3](#); [17 NCAC 06B .4005](#).

## **6. Distributions**

A resident shareholder must take into account distributions from an S corporation in computing North Carolina taxable income to the extent the distributions are characterized as dividends or as gains pursuant to section 1368 of the Internal Revenue Code. Section 1368 of the Code provides that if the S corporation has no accumulated earnings and profits, the amount distributed to a shareholder reduces the adjusted basis in the shareholder's stock. If the distribution exceeds the shareholder's basis, the excess is treated as a capital gain. If the S corporation has earnings and profits, the distribution is applied in the following order:

- (1)** To the Accumulated Adjustments Account (AAA) which essentially includes the income during the period the corporation has been an S corporation reduced by its losses and distributions during that period. The AAA for State income tax purposes *does not* include the federal AAA for tax years beginning prior to January 1, 1989. The shareholder does not take into account distributions from the AAA in determining taxable income but such distributions reduce the adjusted basis of the shareholder's stock.
- (2)** To Earnings and Profits (E and P): An S corporation is not considered to have earnings and profits for State tax purposes for years in which it operates as an S corporation after January 1, 1989. The E and P account basically includes the earnings and profits on hand from the period the corporation was a C corporation; and for State tax purposes, the E and P account also includes the undistributed earnings and profits of the S corporation from tax years beginning before January 1, 1989, (the federal AAA that existed on the day North Carolina began to measure the S corporation shareholder's income by reference to the income of the S corporation). The amount distributed to the shareholder from the E and P account is taxed to the shareholder as a dividend. Since the State E and P account includes the federal AAA that existed prior to the change in State law taxing the S corporation income to the shareholders, federal adjusted gross income must be increased for any distributions from the federal AAA that existed prior to the law change.

- (3) To the basis of the shareholder's stock. Any excess over the shareholder's basis is taxed as a capital gain.

A shareholder who makes an election for federal tax purposes to treat distributions from the S corporation as being paid first from earnings and profits may not make a different election for State purposes.

*Reference:* [G.S. § 105-131.6](#); [17 NCAC 06B .4006](#).

## **7. Losses**

The amount of loss a shareholder may deduct is limited to the adjusted basis of the shareholder's stock, plus the adjusted basis of any loans owed to the shareholder by the corporation. The amount of the loss for the taxable period is figured before the shareholder's basis in the stock is adjusted for any distributions during the tax year. If the amount of the loss of a shareholder is limited because it exceeds the adjusted basis, the excess is treated as incurred by the corporation in the next tax year.

*Reference:* [G.S. § 105-131.4](#).

## **8. Foreign S Corporations**

North Carolina income tax is required to be withheld from compensation paid to foreign S corporations for certain personal services performed in North Carolina. For more information, see [Withholding from Non-Wage Compensation](#). If the S corporation has obtained a certificate of authority from the Secretary of State, no tax is required to be withheld if the S corporation provides to the payer the S corporation's corporate identification number issued by the Secretary of State.

S corporations may claim credit on the S corporation franchise and income tax return, [Form CD-401S](#), for the portion of the tax withheld attributable to shareholders on whose behalf the corporation files a composite return. The portion of the tax withheld attributable to shareholders who are not part of a composite return must be allocated to those shareholders on Schedule K of the S corporation return.

## **9. Time and Place for Filing Returns**

[Form CD-401S](#) is required to be filed on or before April 15 if on a calendar year basis and on or before the 15th day of the fourth month following the end of the fiscal year if on a fiscal year basis. If the return cannot be filed by the due date, the S corporation may apply for an automatic six-month extension of time to file the return. An S corporation that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina income tax return. To receive an automatic State extension, the S corporation must certify on the North Carolina tax return that it was granted

an automatic federal extension. If the S corporation is not granted an automatic federal extension, the S corporation must file [Form CD-419](#), Application for Extension for Filing Corporate Income and Franchise Tax Return, by the original due date of the return to receive a state extension. For information on when a document is considered timely filed, see [Departmental Directive TA-16-1](#) and [Departmental Directive TA-18-1](#).

For information on filing an Application for Extension for Filing an Individual Income Tax Return ([Form D-410](#)), see [Extensions](#). For more information on filing an Individual Income Tax Return, see [Form D-401](#).

*Reference:* [G.S. § 105-131.7](#).

## IX. Estates and Trusts

### 1. North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust

On June 21, 2019, the United States Supreme Court held that the presence of “in-state beneficiaries alone does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it.” 139 S. Ct. 2213, 2221 (2019). By contrast, the United States Supreme Court stated that taxation of trust income based on distributions of trust income to an in-state resident, a trustee’s in-state residence, or in-state trust administration does not violate the Constitution. *Id.* at 2220.

Trusts with these or other connections to the State should carefully analyze those connections to determine if the connections are sufficient for the State to tax the entity’s undistributed taxable income under the Due Process Clause. Income that is exempt from North Carolina tax under the United States Supreme Court’s holding in *North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust* is excluded from North Carolina taxable income using line 6 of [Form D-407](#).

### 2. General

All income of an estate or trust is taxed to the fiduciary or the beneficiary. The conduit rules for taxing estates and trusts are applicable for North Carolina income tax purposes. Under the conduit rules, regardless of who is taxed, the income retains its same character as when received by the estate or trust.

A trust is neither a resident nor a nonresident. A trust’s North Carolina income tax liability is determined based, in part, on the situs of the income beneficiaries, not where the trust was established or where the trustee lives. North Carolina law requires the tax to be computed on the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (1) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (2) is derived from a business, trade, profession, or occupation carried on in this State.

*Reference:* [G.S. § 105-160](#).

### 3. Income Tax Return for Estates and Trusts

The federal taxable income of the estate or trust is the starting point for preparing a North Carolina Income Tax Return for Estates and Trusts, [Form D-407](#), and requires the same additions and deductions to income as required for individuals. **Important.** The fiduciary must determine the estate’s or trust’s federal taxable income before completing Form D-407. In



addition, an estate and trust must add to federal taxable income any state, local, or foreign income tax deducted on the federal estates and trusts return.

The fiduciary responsible for administering the estate or trust is responsible for filing the return and paying the tax. The fiduciary must file an income tax return for the estate or trust for which he acts if he is required to file a federal return for estates and trusts and (1) the estate or trust derives income from North Carolina sources or (2) the estate or trust derives any income which is for the benefit of a resident of North Carolina.

**Exception:** With respect to grantor trust returns, North Carolina has access to the federal information contained in the federal grantor trust returns. Therefore, a State grantor trust return is not required to be filed when the entire trust is treated as a grantor trust for federal tax purposes.

*Reference:* [G.S. § 105-160.2](#); [17 NCAC 06B .3716](#).

#### **4. Time and Place for Filing an Estates and Trusts Tax Return**

[Form D-407](#) is required to be filed on or before April 15 if on a calendar year basis and on or before the 15th day of the fourth month following the end of the fiscal year if on a fiscal year basis. If the return cannot be filed by the due date, the fiduciary may apply for an automatic six-month extension of time to file the return. An estate or trust that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina income tax return. To receive an automatic State extension, the estate or trust must certify on the North Carolina tax return that it was granted an automatic federal extension. If the estate or trust is not granted an automatic federal extension, the estate or trust must file [Form D-410P](#), Application for Extension for Filing Partnership, Estate, or Trust Tax Return, by the original due date of the return to receive an extension for North Carolina purposes.

For information on when a document is considered timely filed, see [Departmental Directive TA-16-1](#) and [Departmental Directive TA-18-1](#).

*Reference:* [G.S. § 105-160.6](#).

#### **5. Payment of Tax**

The tax rate for estates and trusts is the same as the tax rate for individuals. The tax due on the estates and trusts return is payable in full by the due date of the return. For more information, see [Tax Rate Schedules](#).

*Reference:* [G.S. § 105-160.2](#).

## **6. Penalties**

The penalty for failure to file an estate or trust return by the due date is 5% of the net tax due per month with a maximum of 25% of the net tax due. Net tax due is the amount of tax required to be shown on the return less any timely payments of the tax and allowable credits. The penalty for failure to pay the tax by the due date is 10% of the tax shown due on the return less any timely payments of the tax and allowable credits.

Other penalties for fraud, negligence, and criminal penalties for willful failure to comply with the income tax laws are similar to those applicable to individuals. For more information, see [Penalties and Interest](#).

*Reference:* [17 NCAC 06B .3203](#).

## **7. Allocation of Adjustments**

The additions and deductions to income of an estate or trust must be apportioned between the estate or trust and the beneficiaries based on the distributions of income made during the taxable year. If the trust instrument or will that created the estate or trust does not provide for the distribution of certain classes of income to different beneficiaries, the apportionment of additions and deductions to the beneficiaries is determined on the basis that each beneficiary's share of the estate's or trust's "total income," the sum of lines 1 through 8 on the beneficiary's Schedule K-1, Federal Form 1041 relates to adjusted total income from line 17 of federal form 1041. If the trust instrument or will specifically provide for the distribution of certain classes of income to different beneficiaries, any addition or deduction directly attributable to a particular class of income must be apportioned to the beneficiaries to which that class of income is distributed. In allocating the adjustments, for State purposes the amount of "total income" on federal Schedule K-1 must be adjusted for distributions to the beneficiary that are not reflected in "total income." The adjusted total income on federal form 1041 must be adjusted (1) to exclude classes of income that are not part of the distribution to the beneficiary; (2) to include classes of income that are a part of the distribution to the beneficiary which are not included in adjusted total income; and (3) by any deduction treated differently for State and federal tax purposes that adjust income pursuant to [G.S. § 105-153.5](#) and [G.S. § 105-153.6](#). After apportioning the additions and deductions to the beneficiaries, the balance is apportioned to the fiduciary.

*Reference:* [17 NCAC 06B .3723](#).

## **8. Allocation of Income Attributable to Nonresidents**

If the estate or trust has income from sources outside of North Carolina and if any of the beneficiaries are nonresidents of North Carolina, the portion of federal income of the fiduciary that is subject to North Carolina tax must be determined. If there is no gross income from dividends, interest, other intangibles, or from sources outside North Carolina for the benefit of a nonresident beneficiary, the total income of the estate or trust is taxable to the fiduciary.

The determination of the amount of undistributed income from intangible property which is for the benefit of a resident is based on the beneficiary's state of residence on the last day of the taxable year of the trust. In the case of both resident and nonresident beneficiaries, the determination of the amount of undistributed income from intangible property which is for the benefit of a resident is made on the basis that the resident beneficiary's interest for the taxable year relates to the interest of both resident and nonresident income beneficiaries for the taxable year.

*Reference:* [17 NCAC 06B .3724.](#)

## **9. Tax Credits**

Estates and trusts are allowed all tax credits allowed to individuals except for the tax credit for income taxes paid by individuals to other states or countries.

[Form D-407TC](#), Estates and Trusts Tax Credit Summary, is used to report any tax credits claimed on an estate or trust return. The amounts reflected on "Form D-407TC" are the portions of the tax credits allocated to the trust or estate. A fiduciary required to pay an income tax to North Carolina for a trust for which he acts may claim a credit for tax imposed and paid to another state or country on income from sources within that state or country under the provisions of [G.S. § 105-160.4\(a\)](#).

A resident beneficiary of an estate or trust, the fiduciary of which pays an income tax to another state or country on distributable income reportable to North Carolina which is derived from sources in the other state or country may claim a credit against the resident beneficiary's North Carolina income tax for the resident beneficiary's share of tax paid to the other state or country under the provisions of [G.S. § 105-160.4\(e\)](#).

Part 5 of [Form D-407TC](#) is to be used in computing the tax credit allowable to the estate or trust. Before this schedule may be completed, there must be an allocation between the estate or trust and its beneficiaries of the tax paid and the gross income on which such tax was paid to the other state or country.

The fiduciary's share and each beneficiary's share of the gross income on which tax has been paid to another state or country is determined by the governing instrument and should be entered in the appropriate schedule on the return. The fiduciary's share of total gross income to be used in the tax credit computation schedule is the total gross income from federal Form 1041.

*Reference:* [G.S. § 105-160.3](#); [17 NCAC 06B .3714.](#)

# X. Tax Credits

## 1. Overview

Many of the tax credits previously available to individuals have been repealed or designated for sunset. Please refer to each specific Article for details.

*Reference:* Articles [3A](#), [3B](#), [3D](#), [3E](#), [3F](#), [3G](#), [3H](#), [3J](#), [3K](#), [3L](#) and [4](#).

### a. Effect on Installments and Carryforwards

A taxpayer that qualified for a tax credit that has expired or has 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. Forms

[Form D-400TC](#) 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. The applicable NC-478 series form is used to calculate the specific tax credit without regard to the fifty percent (50%) limitation. [Form NC-478](#) is used to total the specific tax credits, to determine if the fifty percent (50%) limitation applies, and allocate the limited total credit among the specific tax credits.

[Form D-400TC](#) 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.

## 2. Article 4 Tax Credits

### a. Credit for Income Tax Paid to another State or Country

A tax credit is allowed to an individual who is a resident of North Carolina for tax imposed by and paid to another state or country on income that is also taxed by North Carolina, subject to the following conditions:

1. The income must have been derived from sources in the other state or country and must have been taxed under the laws of that state or country, regardless of the legal residence of the taxpayer.

2. The credit allowable is the smaller of either the net tax paid the other state or country on income also taxed by North Carolina or the product obtained by multiplying the North Carolina tax computed before credit by a fraction in which the numerator is the part of the North Carolina income, as adjusted, which is taxed in the other state or country and the denominator is the total income as adjusted, received while a resident of North Carolina. If credits are claimed for taxes paid to more than one state or country, a separate computation must be made for each state or country and the separate credits combined to determine the total credit.
3. Receipt or other proof showing payment of income tax to the other state or country and a copy of the return filed with the other state or country must be submitted with the North Carolina return. No credit is allowed for income taxes paid to a city, county, or other political subdivision of a state or country or to the federal government. Some foreign countries do not require individuals to file income tax returns. Instead, their income tax liability is paid through withholding. The Department will accept evidence of the withholding to substantiate the tax credit.

If any tax for which a resident has claimed a tax credit on the North Carolina income tax return is refunded at any time by the other state or country, a tax equal to that portion of the credit allowed for the taxes credited or refunded is due and payable from the taxpayer and is subject to penalties and interest.

The tax credit allowed to a North Carolina resident is determined as follows:

$$\frac{\text{Portion of total federal income while a resident of N.C., as adjusted, that was taxed by another state or country}}{\text{Total federal income while a resident of N.C., as adjusted}} \times \text{N.C. income tax} = \text{Tax credit}$$

After making the computation by use of this formula, the tax credit allowed is either the credit obtained by use of the formula or the actual amount of net income tax paid to the other state or country, whichever is the smaller.

**Example 1.** A full-year resident of North Carolina files a 2019 North Carolina return as a single individual. His total federal gross income and federal adjusted gross income are \$40,000. He worked temporarily in South Carolina, earning \$5,000 on which he paid tax of \$131 to South Carolina. Taxpayer claimed the N.C. standard deduction of \$10,000. The credit against his North Carolina income tax is determined as follows:

Federal adjusted gross income .....	\$ 40,000
Less: N.C. standard deduction .....	(10,000)
North Carolina taxable income .....	<u>\$ 30,000</u>
North Carolina tax .....	\$1,575

Less tax credit:

Portion of total federal gross income, while a resident of N.C., as adjusted, taxed by South Carolina	<u>\$5,000</u>	x	\$1,575	=	\$197
Total federal gross income as adjusted, while a resident of N.C.	<u>\$40,000</u>				

Since the \$131 tax paid to South Carolina is less than the computed tax credit of \$197 the allowable tax credit is the actual tax paid to South Carolina. Therefore, the North Carolina tax due is \$1,444 (\$1,575 – \$131).

**Example 2.** A husband and wife are both residents of North Carolina and file a joint 2019 North Carolina income tax return. Their total federal gross income and federal adjusted gross income are \$40,000, \$5,500 of which was received from rental property, owned jointly, in Virginia. A total of \$2,000 was received by the husband for temporary employment in South Carolina. The taxpayers claimed the N.C. standard deduction of \$20,000. They paid tax of \$290 on the income earned in Virginia and the husband paid tax of \$102 on the income reported to South Carolina. The credit against their North Carolina income tax is determined as follows:

Federal adjusted gross income .....	\$40,000
Less: N.C. standard deduction .....	<u>(20,000)</u>
North Carolina taxable income .....	\$ <u>20,000</u>

North Carolina tax..... \$1,050

Less tax credit:

Portion of total federal gross income while a resident of N.C., as adjusted, taxed by Virginia	<u>\$5,500</u>	x	\$1,050	=	\$144
Total federal gross income, as adjusted, while a resident of N.C.	<u>\$40,000</u>				

Portion of total federal gross income while a resident of N.C., as adjusted, taxed by South Carolina	<u>\$2,000</u>	x	\$1,050	=	\$53
Total federal gross income, as adjusted, while a resident of N.C.	<u>\$40,000</u>				

Total credit .....	<u>\$(197)</u>
North Carolina tax due.....	<u>\$853</u>

The computed credits are allowed since each is less than the amount paid to the other state.

**Example 3.** Taxpayer, a single man, became a North Carolina resident on June 1, 2019. Prior to moving to North Carolina, he earned \$4,000 in South Carolina. From June 1 through December 31, 2019, he earned \$6,000 in South Carolina and \$10,000 in North Carolina. He paid income tax to South Carolina of \$250 on the \$10,000 of South Carolina income. The taxpayer claimed the N.C. standard deduction of \$10,000. His tax credit is determined as follows:

Federal adjusted income .....	\$20,000
Less: N.C. standard deduction .....	(10,000)
North Carolina taxable income before part-year resident adjustment .....	\$10,000

Total federal gross income, as adjusted, while a N.C. resident plus total income from N.C.

sources while a nonresident, as adjusted	\$16,000	x	\$10,000 = \$8,000
Total federal gross income from all sources, as adjusted	\$20,000		

North Carolina taxable income .....	\$8,000
North Carolina tax on \$8,000 taxable income .....	\$420

Less tax credit:

Portion of total federal gross income, while a N.C. resident, as adjusted, taxed by S.C.	\$6,000	x	\$420 = \$158*
Total federal gross income while a N.C. resident, as adjusted	\$16,000		N.C. tax

\* (The computed credit is determined only with respect to income while the taxpayer is a resident of North Carolina.)

S.C. income taxed by N.C.	\$6,000	x	\$250 = \$150**
Total S.C. income	\$10,000		S.C. tax

Since the \$150 tax paid to South Carolina on income also taxed by North Carolina is less than the \$158 computed credit, the allowable credit is \$150. Therefore, the North Carolina tax due is \$270 (\$420-150).

\*\* (Since a part of the tax paid to South Carolina was on income not taxed by North Carolina, this computation is necessary to determine that portion of the South Carolina tax that was paid on income also taxed by North Carolina.)

Reference: [G.S. § 105-153.9](#); [17 NCAC 06B .0607](#).

## **b. Credit for Corporate Tax Paid by S Corporation to Another State or Country**

Credit is allowed to a resident shareholder for the shareholder's share of the corporate tax paid by an S corporation to another state or country that taxes the corporation rather than the shareholder on the S corporation's income, or the computed credit, whichever is less. If credit is claimed for the shareholder's part of the corporate tax paid, a schedule must be attached to the North Carolina return showing the total tax paid by the S corporation and how the pro rata share of the tax was determined. A separate tax credit must be calculated for each state or country to which the S corporation paid tax.

*Reference:* [G.S. § 105-131.8](#).

## **3. Tax Incentives for New and Expanding Businesses**

For most taxpayers, Article 3A credits expired for activities that occurred on or after January 1, 2007. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [Article 3A](#).

## **4. Business & Energy Tax Credits**

### **a. General** (*Applies to all credits under this Article unless otherwise noted.*)

#### **1. Franchise, Income, or Gross Premiums Tax Election**

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.

*Reference:* [G.S. § 105-129.17\(a\)](#).

#### **2. Cap on Credit**

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.

*Reference:* [G.S. § 105-129.17\(b\)](#).



### **3. Credit Carryforward**

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.

*Reference:* [G.S. § 105-129.17\(b\)](#).

### **4. Substantiation**

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.

*Reference:* [G.S. § 105-129.18](#).

#### **b. Credit for Investing in Renewable Energy Property**

For most taxpayers, this credit was repealed effective for renewable energy property placed in service on or after January 1, 2016. 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. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

#### **c. Credit for Constructing Renewable Fuel Facilities**

For most taxpayers, this credit was repealed effective for renewable fuel facilities placed in service on or after January 1, 2014. The sunset of the production credit (G.S. § 105-129.16D(b)) was extended to January 1, 2020, for facilities placed in service on or after that date if the taxpayer met both of the following conditions:

- The taxpayer signed a letter of commitment with the Department of Commerce on or before September 1, 2013, stating the taxpayer's intent to construct and place in service in this State a commercial facility for processing renewable fuel.
- The taxpayer began construction of the facility on or before December 31, 2013.

Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [G.S. § 105-129.16D](#).

**d. Credit for Biodiesel Producers**

This credit expired for tax years beginning on or after January 1, 2014. Eligible taxpayers may continue to take remaining carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [G.S. § 105-129.16F](#).

**e. Work Opportunity Tax Credit**

This credit expired for tax years beginning on or after January 1, 2014. Eligible taxpayers may continue to take remaining carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [G.S. § 105-129.16G](#).

**f. Credit for Donations to a Nonprofit Organization or Unit of State or Local Government for Acquisition of Renewable Energy Property**

This credit expires as of the date that the credit for investing in renewable energy property expires. For most taxpayers, the credit for investing in renewable energy property was repealed effective for renewable energy property placed in service on or after January 1, 2016.

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. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [G.S. § 105-129.16H](#).

**5. Article 3D Historic Rehabilitation Tax Credits**

This Article expired for qualified expenditures and rehabilitation expenses incurred on or after January 1, 2015, and was replaced with a new historic rehabilitation credit in [Article 3L](#). For qualified expenditures and rehabilitation expenses incurred before January 1, 2015, the Article expires for property not placed in service by January 1, 2023. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [Article 3D](#).

## **6. Article 3E Low-Income Housing Tax Credits**

This Article was repealed effective after January 1, 2015. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [Article 3E](#).

## **7. Article 3F Research and Development Credit**

This Article was repealed for taxable years beginning on or after January 1, 2016. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

*Reference:* [Article 3F](#).

## **8. Article 3H Credit for Mill Rehabilitation**

Except for credits allowed under new subsection G.S. 105-129.71(a1), this Article expired January 1, 2015, for rehabilitation projects for which an application for an eligibility certification was submitted on or after such date. Eligibility certifications for this Article expire January 1, 2023. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form.

This Article was amended by the 2019 General Assembly to add new subsection (a1) to G.S. 105-129.71. This new subsection creates a credit for taxpayers that qualify for a credit under section 47 of the Code for making qualified rehabilitation expenditures of at least ten million dollars to a certified rehabilitation of an eligible railroad station. "Eligible railroad station" is a site located in North Carolina that satisfies all of the following conditions:

- (1) It was used as a manufacturing facility and either (i) was used as a railroad station or (ii) is located adjacent to a site that is or was used as a railroad station.
- (2) It is a certified historic structure or a State-certified historic structure.
- (3) It has been at least eighty percent (80%) vacant for a period of at least two years immediately preceding the date the eligibility certification is made.
- (4) It is a designated local landmark as certified by a city on or before June 30, 2019.
- (5) It is located in a development tier one or tier two area, determined as of the date of the eligibility certification.
- (6) It is located in a designated qualified opportunity zone under sections 1400Z-1 and 1400Z-2 of the Code, determined as of the date of the eligibility certification.
- (7) It is issued a certificate of occupancy on or before December 31, 2021.

The G.S. 105-129.71(a1) credit is equal to 40% of the qualified rehabilitation expenditures. The qualified rehabilitation expenditures must be incurred on or after January 1, 2019, and before January 1, 2022. The G.S. 105-127.71(a1) credit may not be claimed for rehabilitation

projects not completed and placed in service prior to January 1, 2022. The credit cannot be claimed for a taxable year beginning prior to January 1, 2021. The tax credit must be taken in two equal installments on returns filed for taxable years 2021 and 2022.

*Reference:* [Article 3H. Session Law 2019-237.](#)

## **9. Article 3J Tax Credits for Growing Businesses**

This Article expired for business activities that occurred on or after January 1, 2014. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable [Form NC-478](#) series form. For more information, see [Guidelines for Article 3J Tax Credits.](#)

*Reference:* [Article 3J.](#)

## **10. Tax Incentive for Railroad Intermodal Facility**

### **a. Credit**

A taxpayer that constructs or leases an eligible railroad intermodal facility in this State 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 if the facility is placed in service in this State during the taxable year. No credit is allowed under this section to the extent the cost of the eligible railroad intermodal facility was provided by public funds. 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.

*Reference:* [G.S. § 105-129.96.](#)

### **b. Taxes Credited**

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.

*Reference:* [G.S. § 105-129.96.](#)

### **c. No Double Credit**

A taxpayer may not take the credit allowed in this section for an eligible railroad intermodal facility the taxpayer leases from another unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit under this Chapter with respect to the facility.

*Reference:* [G.S. 105-129.96.](#)

**d. Definitions**

**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.

**Eligible railroad intermodal facility.** A railroad intermodal facility for which the costs of construction exceed thirty million dollars (\$30,000,000).

**Intermodal facility.** A facility where freight is transferred from one mode of transportation to another.

**Railroad intermodal facility.** An intermodal facility whose primary purpose is to transfer freight between a railroad and another mode of transportation.

*Reference:* [G.S. § 105-129.95](#).

**e. Substantiation**

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.

*Reference:* [G.S. § 105-129.97](#).

**f. Reports**

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.

*Reference:* [G.S. § 105-129.98](#).

**g. Sunset**

This Article is repealed effective for taxable years beginning on or after January 1, 2038.

*Reference:* [G.S. § 105-129.99](#).

## 11. Article 3L Historic Rehabilitation Tax Credits

### a. General

This Article replaced [Article 3D](#) credits and was effective for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2016.

*Reference:* [Article 3L](#).

#### 1. Tax Credited

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 on which it is claimed. Any future carryforwards of unused credits must be claimed against the same tax.

*Reference:* [G.S. § 105-129.108\(a\)](#).

#### 2. General Credit Limitations

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 [Article 3H](#) with respect to the same activity. Any unused portion of a credit may be carried forward for the succeeding nine (9) years.

*Reference:* [G.S. § 105-129.108\(c\)](#).

#### 3. Forms

A taxpayer must claim the historic rehabilitation tax credit on the tax return filed for the taxable year in which the certified historic structure is placed into service. In the year the taxpayer qualifies for the tax credit, [Form NC-Rehab](#) must be filed. This requirement applies even if the taxpayer's tax liability for that year is not large enough for the taxpayer to take the tax credit. For more information, see the [Instructions for Form NC-Rehab](#).

In addition, [Form D-400TC](#) 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.

*Reference:* [G.S. § 105-129.108\(b\)](#).

#### 4. Rules and Fees

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.

*Reference:* [G.S. § 105-129.107](#).

#### 5. Sunset

[Article 3L](#) expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2024. For qualified expenditures and rehabilitation expenses incurred prior to January 1, 2024, the Article expires for property not placed in service by January 1, 2032.

*Reference:* [G.S. § 105-129.110](#); [Session Law 2019-237](#).

### b. Credit for Rehabilitating Income-Producing Historic Structure

#### 1. Credit

A taxpayer who is allowed a federal income tax credit under section 47 of the Internal Revenue Code for making qualified rehabilitation expenditures for a certified historic structure located in North Carolina is allowed a 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 years 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 a certification obtained from the State Historic Preservation Officer, defined in [G.S. § 105-129.105\(c\)\(7\)](#).

*Reference:* [G.S. § 105-129.105\(a\)](#).

## **2. Credit Limitation**

The total amount of credit allowed for qualified rehabilitation expenditures for an income-producing certified historic structure may not exceed 4.5 million dollars.

*Reference:* [G.S. § 105-129.105\(d\)](#).

## **3. 2014 and 2015 Expenses**

Expenditures that were incurred in taxable years prior to taxable year 2016 generally do not qualify for this credit. Expenditures incurred in 2014 and 2015 will qualify for this credit if all of the following conditions are met:

- a. The certified historic structure is located in a Tier 1 or Tier 2 county.
- b. The certified historic structure is owned by a city.
- c. The qualified rehabilitation activity commenced in 2014.
- d. A certificate of occupancy is issued on or before December 31, 2015.
- e. The taxpayer meets all of the other conditions in G.S. 105-129.105.

*Reference:* [G.S. § 105-129.105\(e\)](#).

## **4. Allocation from 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 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](#).

The credit for rehabilitating an income-producing historic structure is claimed in the taxable year in which the property is placed in service. When an income-producing property is placed in service in two or more phases in different years, the amount of credit that may be claimed in a year is the amount based on the qualified rehabilitation



expenditures associated with the phase placed in service during that year. Any unused portion of the credit may be carried forward for the succeeding nine years.

*Reference:* [G.S. § 105-129.105\(b\)](#).

## **5. Forfeiture for Disposition**

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.

*Reference:* [G.S. § 105-129.108\(d\)](#).

## **6. Forfeiture for Change in Ownership**

If an owner of a pass-through entity that has qualified for the credit allowed under [G.S. § 105-129.105](#) 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.

*Reference:* [G.S. § 105-129.108\(e\)](#).

## **7. Exceptions to Forfeiture**

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.

*Reference:* [G.S. § 105-129.108\(f\)](#).

## **8. Liability from Forfeiture**

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](#).

*Reference:* [G.S. § 105-129.108\(g\)](#).

## **9. Substantiation**

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.

*Reference:* [G.S. § 105-129.108\(h\)](#).

### **c. Credit for Rehabilitating Nonincome-Producing Historic Structure**

#### **1. Credit**

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 and added to the property’s basis. The expenses must be incurred within 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. § 105-129.106\(c\)\(5\)](#), as contributing to the historic significance of a National Register Historic District or locally district certified by the U.S. Department of the Interior.

*Reference:* [G.S. § 105-129.106\(a\)](#).

## **2. Limitations**

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 allowed a credit for the rehabilitation expenses made by the transferor only if the transfer occurs before the structure is placed in service. In such a case, the transferor must provide the transferee with documentation detailing the amount of rehabilitation expenses and credit. 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 for rehabilitating a nonincome-producing historic structure once during any five year period, not including carryovers.

*Reference:* [G.S. § 105-129.106\(b\)](#).

## **3. Substantiation**

The credit for rehabilitating a nonincome-producing historic structure is claimed in the taxable year in which the property is placed in service. Any unused portion of the credit may be carried forward for the succeeding nine years.

*Reference:* [G.S. § 105-129.108\(h\)](#).

# XI. Withholding of Income Tax

## 1. General

G.S. § 105-163.1 through G.S. § 105-163.10 and G.S. § 105-163.22 through G.S. § 105-163.24 require employers, pension payers, and other payers to withhold income tax from payments of wages, non-wage compensation, pensions, and lottery winnings.

*Reference:* [Article 4A](#).

## 2. Withholding From Wages

### a. General

Income tax must be withheld according to tables prepared by the Department or by using an acceptable alternate method and employers must pay over the amount withheld to the Department. The requirements are explained in [Publication NC-30](#), Income Tax Withholding Tables and Instructions for Employers.

“Wages” is defined for North Carolina withholding purposes as having the same meaning as in section 3401 of the Code. Effective August 1, 2019, wages paid to certain nonresident employees engaged in disaster relief work at the request of a critical infrastructure company are excluded from the withholding requirements of G.S. 105-163.2 and employers are not required to withhold state income taxes from the wages paid to these employees. See [Critical Infrastructure Disaster Relief Work](#) for additional information.

If an employer enters into a voluntary agreement to withhold North Carolina tax on income not requiring withholding, the amount withheld will be accepted and the employee will receive credit on the annual income tax return provided the rules which apply to withholding are followed. Since the agreement to withhold is voluntary between the employer and the employee and is not required by law, the employee cannot receive credit for any amount withheld that is not properly paid to the Department of Revenue.

*Reference:* [G.S. § 105-163.1](#); [G.S. § 105-163.2](#).

### b. Annual Statements

#### 1. Informational Return to Secretary

Every employer who is required to or voluntarily withholds North Carolina income taxes must file [Form NC-3](#), Annual Withholding Reconciliation, and the required W-2 and 1099 statements (collectively “Form NC-3”). Form NC-3 must be filed in an electronic format as prescribed by the Secretary. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State’s copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the eNC3 and Information Reporting Application located on the Department’s website.

**Note:** For tax year 2020, the Secretary elected to continue the automatic waiver of the penalty for failure to file Form NC-3 in the format prescribed by the Secretary. For more information, see the Department's [Important Notice dated October 2, 2020](#).

Unless an employer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed with the Department on or before January 31 for the preceding calendar year. During the calendar year, if an employer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed within 30 days of the date on which the employer closed the business. If an employer does not timely file Form NC-3 either electronically or by paper on or before the due date, the Secretary will impose a failure to timely file penalty against the employer as prescribed under [G.S. 105-236\(a\)\(10\)\(c\)](#). The failure to file penalty is \$50 per day, up to a maximum of \$1,000, for failure to file certain informational returns with the Secretary by the date the return is due.

**Note:** A request to waive the failure to timely file an informational return penalty will affect an employer's good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department's [Penalty Waiver Policy](#)) allows every taxpayer one penalty waiver for most tax types every three years.

For additional details, see [Reporting and Paying Tax Withheld](#).

*Reference:* [G.S. § 105-163.7](#); [G.S. § 105-236\(a\)\(10\)](#); [G.S. § 105-228.90](#), [17 NCAC 06C .0203](#).

## **2. Report to Income Recipients**

Every employer who is required to or voluntarily withholds North Carolina income taxes from wages, non-wage compensation, or pension payments must furnish the recipient of the income a form or statement that reports the remuneration paid by the employer to the recipient during the calendar year, the total amount deducted and withheld from the remuneration, the employers identification information, and the recipient's identification information. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if an employer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For additional details, see [Reporting and Paying Tax Withheld](#).

*Reference:* [G.S. § 105-163.7](#); [G.S. § 105-228.90](#); [17 NCAC 06C .0203](#).

### 3. Withholding From Pensions, Annuities, and Deferred Compensation

#### a. General

A pension payer required to withhold federal tax under section 3405 of the Code on a pension payment to a North Carolina resident must also withhold State income tax from the pension payment. If a payee has provided a North Carolina address to a pension payer, the payee is presumed to be a North Carolina resident and the payer is required to withhold State tax unless the payee elects no withholding. A pension payer that either fails to withhold or to remit tax that is withheld is liable for the tax.

A pension payer must treat a pension payment paid to an individual as if it were an employer's payment of wages to an employee. If the pension payer has more than one arrangement under which distributions may be made to an individual, each arrangement must be treated separately.

*Reference:* [G.S. § 105-163.2A](#).

#### b. Definitions

Unless otherwise specified below, the definitions, provisions, and requirements of section 3405 of the Internal Revenue Code with respect to federal withholding on pensions are applicable to State withholding on pensions.

**Pension payer.** A payer or a plan administrator with respect to a pension payment under section 3405 of the Code.

**Pension payment.** A periodic payment or a nonperiodic distribution, as those terms are defined in section 3405 of the Code.

*Reference:* [G.S. § 105-163.2A\(a\)](#).

#### c. Amount to Withhold

In the case of a **periodic payment**, as defined in Code section 3405(e)(2), the payer must withhold as if the recipient were single with no allowances unless the recipient provides an exemption certificate, [Form NC-4P](#), Withholding Certificate for Pension or Annuity Payments, reflecting a different filing status or number of allowances. [Form NC-4P](#) is used by a recipient of pension payments who is a North Carolina resident to report the correct filing status, number of allowances, and any additional amount the recipient wants withheld from the pension payment. It may also be used to elect not to have State income tax withheld. In lieu of [Form NC-4P](#), payers may use a substitute form if it contains all the provisions included on [Form NC-4P](#).

For a **nonperiodic distribution**, as defined in Code section 3405(e)(3), 4% of the distribution must be withheld. A nonperiodic distribution includes an eligible rollover

distribution as defined in Code section 3405(c)(3). State law differs from federal law with respect to eligible rollover distributions. Federal law imposes a higher rate of withholding on eligible rollover distributions than on other nonperiodic distributions. State law imposes the same rate of withholding on all nonperiodic distributions.

*Reference:* [G.S. § 105-163.2A\(c\)](#).

**d. Election Not to Have Income Tax Withheld**

A recipient may elect not to have income tax withheld from a pension payment unless the pension payment is an eligible rollover distribution as defined in Code section 3405(c)(3). A recipient of a pension payment that is an eligible rollover distribution does not have the option of electing not to have State tax withheld from the distribution.

An election not to have tax withheld from a pension payment remains in effect until revoked by the recipient. An election not to have tax withheld is void if the recipient does not furnish the recipient's tax identification number to the payer or furnishes an incorrect identification number. In such cases, the payer will withhold on periodic payments as if the recipient is single with no allowances and on nonperiodic distributions at the rate of 4%.

A nonresident with a North Carolina address should also use [Form NC-4P](#) to elect not to have State income tax withheld. Completing [Form NC-4P](#) and electing not to have State tax withheld does not infer that the recipient is a resident of North Carolina.

*Reference:* [G.S. § 105-163.2A\(d\)](#).

**e. Exceptions to Withholding**

Tax is not required to be withheld from the following pension payments:

1. A pension payment that is wages.
2. Any portion of a pension payment that meets both of the following conditions:
  - (a) It is not a distribution or payment from an individual retirement plan as defined in section 7701 of the Code.
  - (b) The pension payer reasonably believes it is not taxable to the recipient.
3. A distribution described in section 404(k)(2) of the Code, relating to dividends on corporate securities.
4. A pension payment that consists only of securities of the recipient's employer corporation plus cash not in excess of \$200 in lieu of securities of the employer corporation.

5. Distributions of retirement benefits received from North Carolina State and local government retirement systems and federal retirement systems identified as qualifying retirement systems under the terms of the *Bailey/Emory/Patton* settlement that are paid to retirees who were vested in the retirement systems as of August 12, 1989. For more information, see [Bailey Settlement](#).

*Reference:* [G.S. § 105-163.2A\(e\)](#).

#### **f. Notification Procedures for Pension Payers**

A pension payer is required to provide each recipient with notice of the right not to have State withholding apply and of the right to revoke the election. The notice requirements for North Carolina purposes are the same as the federal notice requirements, which are provided in section 3405(e)(10) of the Code. Section D of Federal Regulation 35.3405-1T contains sample notices that may be modified for State purposes to satisfy the notice and election requirements for periodic payments and nonperiodic distributions. Instead of notification that tax will be withheld unless the recipient chooses not to have tax withheld, pension payers may notify recipients whose annual payments are less than \$10,750 that no State tax will be withheld unless the recipient chooses to have State withholding apply. Such notice may be provided when making the first payment.

#### **g. Reporting and Paying the Withheld Tax**

A pension payer that is required to withhold State tax from a pension payment but is not already registered with the Department of Revenue for wage withholding must register to obtain a withholding account number. The registration can be completed [on the Department's website](#), or by completing [Form NC-BR](#), Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery and Equipment Tax. The payer will be assigned an account identification number that should be recorded in a permanent place and used on all reports and correspondence related to State withholding. A pension payer's initial filing frequency is determined by the average monthly withholding as indicated on [Form NC-BR](#). The filing frequency may change after the first year depending on the amount of tax withheld during the first year.

A payer that withholds tax from pensions and also withholds tax from wages must report the withholding from pensions with the wage withholding unless the payer chooses to report the withholding from pensions separately. For those payers that do not choose to report the two types of withholding separately, the payment of tax withheld from pensions is due at the time the withholding from wages is due and the payer will be subject to penalties and interest on both types of withholding based on that due date. Payers that also withhold from wages but choose to report the withholding from pensions separately must file [Form NC-BR](#) to receive a separate account identification number.

A payer that initially chooses to report withholding from pensions separately may, at any time begin reporting the two types of withholding together. If combined reporting is preferred, a payer should report the combined withholding under the account number for



reporting wages. The payer should complete [Form NC-BN](#), Out-of-Business Notification, for the separate pension withholding account and file it with the Department. The separate withholding account will be closed. A payer that initially reports the two types of withholding at the same time may choose to begin reporting the withholding on pensions separately by notifying the Business Registration Unit. The payer must continue to report the two types of withholding together until the payer receives the separate account identification number from the Department. In either case, the payer must file separate annual reconciliations for the year in which the choice is changed.

## **h. Annual Statements**

### **1. Informational Return to Secretary**

Every pension payer who is required to or voluntarily withholds North Carolina income taxes must file [Form NC-3](#), Annual Withholding Reconciliation, and the required W-2 and 1099 statements (collectively “Form NC-3”). Form NC-3 must be filed in an electronic format as prescribed by the Secretary. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State’s copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the [eNC3 and Information Reporting Application](#) located on the Department’s website.

**Note:** For tax year 2020, the Secretary of Revenue elected to continue the automatic waiver of the penalty for failure to file Form NC-3 in the format prescribed by the Secretary. For more information, see the Department’s [Important Notice dated October 2, 2020](#).

Unless a pension payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed with the Department on or before January 31 for the preceding calendar year. During the calendar year, if a pension payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed within 30 days of the date on which the pension payer closed the business. If a pension payer does not timely file Form NC-3 either electronically or by paper on or before the due date, the Secretary will impose a failure to timely file penalty against the pension payer as prescribed under [G.S. § 105-236\(a\)\(10\)\(c\)](#). The failure to file penalty is \$50 per day, up to a maximum of \$1,000, for failure to file certain informational returns with the Secretary by the date the return is due.

**Important:** A request to waive the failure to timely file an informational return penalty **will affect** a pension payer’s good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department’s [Penalty Waiver Policy](#)) allows every taxpayer one penalty waiver for most tax types every three years.

For additional details, see [Reporting and Paying Tax Withheld](#).

*Reference:* [G.S. § 105-163.2A](#); [G.S. § 105-163.7](#); [G.S. § 105-236\(a\)\(10\)](#); [G.S. § 105-228.90](#); [17 NCAC 06C .0203](#).

## 2. Report to Income Recipients

Every pension payer who is required to or voluntarily withholds North Carolina income taxes from wages, non-wage compensation, or pension payments must furnish the recipient of the income a form or statement that reports the remuneration paid by the pension payer to the recipient during the calendar year, the total amount deducted and withheld from the remuneration, the pension payer's identification information, and the recipient's identification information. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if a pension payer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For additional details, see [Reporting and Paying Tax Withheld](#).

*Reference:* [G.S. § 105-163.2A](#); [G.S. § 105-163.7](#); [G.S. § 105-236\(a\)\(10\)](#); [G.S. § 105-228.90](#); [17 NCAC 06C .0203](#).

## 4. Withholding from Non-Wage Compensation

### a. General

Effective January 1, 2020, North Carolina income tax of four percent (4%) is required to be withheld from non-wage compensation paid to a payee. A payee is defined as any of the following:

1. A nonresident contractor. A nonresident contractor is either of the following:
  - a. A nonresident individual who performs in this State for compensation other than wages any personal services in connection with a performance, an entertainment, an athletic event, a speech, or the creation of a film, radio, or television program.
  - b. A nonresident entity that provides for the performance in this State for compensation of any personal services in connection with a performance, an entertainment, an athletic event, a speech, or the creation of a film, radio, or television program.
2. An ITIN contractor. An ITIN is a nine-digit individual taxpayer identification number issued by the Internal Revenue Service. IRS Publication 1915 states that an ITIN is a nine-digit number beginning with the number "9", has a range of numbers from "50" to "65", "70" to "88", "90" to "92" and "94" to "99" for the fourth and fifth digits and is formatted like a SSN (i.e. 9XX-XX-XXXX). The withholding requirement applies not only to a person whose taxpayer identification number is an ITIN, but also to a person who has applied for an ITIN number and a person whose ITIN number has expired. For more information on the ITIN program, visit the IRS website.

3. A person who performs services in this State for compensation that fails to provide the payer a taxpayer identification number.
4. A person who performs services in this State for compensation that fails to provide the payer a valid taxpayer identification number (“TIN”). The Department of Revenue (“Department”) must notify the payer that the TIN is invalid. If the Department notifies a payer that a payee’s TIN is not valid, the withholding requirement applies to any compensation paid to that payee on or after that date.

The requirement to withhold applies to payers who, in the course of a trade or business, expect to pay more than one thousand five hundred dollars (\$1,500) of non-wage compensation to a payee.

**b. Exceptions to Withholding**

Tax is not required to be withheld from compensation paid to a nonresident entity if the entity meets certain requirements. No tax is required to be withheld if the entity is a corporation or a limited liability company that has obtained a certificate of authority from the Secretary of State. The payer must obtain from the entity and retain in its records the entity’s identification number issued by the Secretary of State.

No tax is required to be withheld from an entity that is exempt from North Carolina corporate income tax under [G.S. § 105-130.11](#). This includes any organization that is exempt from federal income tax under the Internal Revenue Code. The entity must provide verification of this tax exemption to the payer, such as a copy of the organization’s federal determination letter of tax exemption or a copy of a letter of tax exemption from the Department of Revenue.

If an entity is a partnership, no tax is required to be withheld if the partnership has a permanent place of business in this State. The payer must obtain from the partnership and retain in its records the partnership’s address and taxpayer identification number.

Tax is not required to be withheld from personal services paid to an individual who is an ordained or licensed member of the clergy or who is a resident of North Carolina. If the payer does not withhold income tax because the individual is a resident of this State, the payer must retain the individual’s address and social security number in its records.

Tax is not required to be withheld from compensation paid to an ITIN holder who is temporarily admitted to the United States to perform agricultural labor or services under an H-2A visa as described by 8 U.S.C. § 1101(a)(15)(H)(ii)(a) and who is not subject to federal income tax withholding under section 1441 of the Code (these individuals are commonly referred to as H-2A agricultural workers). 8 U.S.C. § 1101(a)(15)(H)(ii)(a) reads as follows: “[A]n alien having a residence in a foreign country which he has no intention of abandoning who is coming temporarily to the United States to perform agricultural labor or services, as defined by the Secretary of Labor in regulations and including agricultural labor defined in section 3121(g) of title 26, agriculture as defined in

section 203(f) of title 29, and the pressing of apples for cider on a farm, of a temporary or seasonal nature.”

For more information, see [Departmental Directive TA-19-1](#).

*Reference:* [G.S. § 105-163.3](#); [G.S. § 105-163.1](#); [Session Law 2019-169](#).

### c. Withholding Threshold

Withholding is required if the payee is expected to be paid more than \$1,500 during the calendar year. If the payment to a payee is \$1,500 or less and, at the time the payment is made, the payer does not believe that the total compensation to be paid to the payee during the year will exceed \$1,500, tax is not required to be withheld. If additional compensation paid to the payee later in the year causes total compensation for the year to exceed \$1,500, the payer is not required to withhold tax from the additional compensation to make up for the compensation from which no tax was withheld.

**Example 1.** A payer pays a payee \$900 in January 2020, and does not expect to make any future payments to the payee.

Because the payment is less than \$1,500, no withholding is required.

**Example 2.** The payer from Example 1 pays the same payee \$800 in September 2020.

The payer must withhold \$32 from the \$800 compensation ( $\$800 \times 4\%$ ) because the total compensation paid to the payee for the year now exceeds \$1,500.

**Example 3.** A payer pays a payee \$1,000 in January 2020, and expects to make future payments to the same payee throughout the year, which are expected to equal or exceed \$1,500.

The payer must withhold \$40 from the \$1,000 compensation ( $\$1,000 \times 4\%$ ) because the total compensation paid to the payee for the year is expected to equal or exceed \$1,500.

For more information, see [Departmental Directive TA-19-1](#).

*Reference:* [G.S. § 105-163.3](#); [G.S. § 105-163.1](#); [Session Law 2019-169](#).

### d. Annual Statements

#### 1. Informational Return to Secretary

Every payer who is required to or voluntarily withholds North Carolina income taxes must file [Form NC-3](#), Annual Withholding Reconciliation, and the required W-2 and 1099 statements (collectively “Form NC-3”). Form NC-3 must be filed in an electronic format as prescribed by the Secretary. For purposes of Form NC-3, the format

prescribed by the Secretary requires Form NC-3 and the State's copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the [eNC3 and Information Reporting Application](#) located on the Department's website. **Note:** For tax year 2020, the Secretary of Revenue elected to continue the automatic waiver of the penalty for failure to file Form NC-3 in the format prescribed by the Secretary. For more information, see the Department's [Important Notice dated October 2, 2020](#).

Unless a payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed with the Department on or before January 31 for the preceding calendar year. During the calendar year, if a payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed within 30 days of the date on which the payer closed the business. If a payer does not timely file Form NC-3 either electronically or by paper on or before the due date, the Secretary will impose a failure to timely file penalty against the payer as prescribed under [G.S. § 105-236\(a\)\(10\)\(c\)](#). The failure to file penalty is \$50 per day, up to a maximum of \$1,000, for failure to file certain informational returns with the Secretary by the date the return is due.

**Important:** A request to waive the failure to timely file an informational return penalty **will affect** a payer's good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department's [Penalty Waiver Policy](#)) allows every taxpayer one penalty waiver for most tax types every three years.

For additional details, see [Reporting and Paying Tax Withheld](#).

*Reference:* [G.S. § 105-163.3](#); [G.S. § 105-163.7](#); [G.S. § 105-236\(a\)\(10\)](#); [G.S. § 105-228.90](#); [17 NCAC 06C .0203](#).

## 2. Report to Income Recipients

Every payer who is required to or voluntarily withholds North Carolina income taxes from wages, non-wage compensation, or pension payments must furnish the recipient of the income a form or statement that reports the remuneration paid by the payer to the recipient during the calendar year, the total amount deducted and withheld from the remuneration, the payer's identification information, and the recipient's identification information. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if a payer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For additional details, see [Reporting and Paying Tax Withheld](#).

*Reference:* [G.S. § 105-163.3](#); [G.S. § 105-163.7](#); [G.S. § 105-236\(a\)\(10\)](#); [G.S. § 105-228.90](#); [17 NCAC 06C .0203](#).

#### e. Refund of Tax Withheld in Error

A payer who improperly withholds tax may refund the amount withheld in error to the payee if:

- The refund is made before the end of the calendar year.
- The refund is made before the payer furnishes the person the annual statement of tax withheld.

The payee must file an income tax return and claim credit for the tax withheld if the refund cannot be issued by the payer based on the above criteria. A payer who makes a refund of tax withheld to a payee should not report the amount refunded on the annual statement nor remit the amount refunded to the Department.

If the payer remits the amount of tax withheld in error to the Department, the payer may only refund the amount of tax withheld in error to the payee if the payer will pay additional compensation to the payee during the tax year. In that case, after refunding the amount withheld in error, the payer must reduce the next payment of tax withheld from compensation paid to the payee by the amount of that refund.

If the payer remits the amount of tax withheld in error to the Department and no additional compensation is due to be paid to the payee, the payer may not refund the tax withheld in error. The payee must file an income tax return and claim credit for the tax withheld.

**Example 1.** A payer pays a payee \$2,500 compensation in July 2020. The payer should have withheld \$100 from the compensation ( $\$2,500 \times 4\%$ ); however, the payer actually withheld \$250 from the compensation. The payer and payee do not discover the error until January 2021.

Because the refund cannot be made before the end of the 2020 calendar year, the payer cannot refund the amount withheld in error to the payee. The payer must report the amount withheld on the annual statement to the payee and the payee must file an income tax return and claim credit for the tax withheld.

**Example 2.** A payer pays a payee \$5,000 compensation in May 2020. The payer should have withheld \$200 from the compensation ( $\$5,000 \times 4\%$ ); however, the payer actually withheld \$500 from the compensation. The payer discovers the error in June 2020 prior to remitting the \$500 of withholding to the Department.

The payer may refund \$300 of tax withheld in error to the payee (\$500 amount withheld - \$200 correct withholding amount). The payer should remit \$200 to the Department and the payer will show \$200 withheld on the annual statement. The payer will not include the amount refunded on the annual statement.

**Example 3.** A payer pays a payee \$10,000 compensation in August 2020. The payer should have withheld \$400 from the compensation (\$10,000 x 4%); however, the payer actually withheld \$1,000 from the compensation. The payer discovers the error in September 2020 after remitting the \$1,000 of withholding to the Department. The payer will owe the ITIN contractor an additional \$20,000 of compensation in October 2020.

The payer may refund \$600 of tax withheld in error to the payee. The payer will calculate withholding on the October 2020 compensation to the payee of \$20,000 as follows:

Standard Calculation: \$20,000 x 4% =	\$800
Reduction for amount of refund remitted to Dept.	<u>-\$600</u>
Withholding amount remitted to Dept.	\$200

The payer will report the \$1,200 of total withholding remitted on the annual statement (\$1,000 remitted in August + \$200 remitted in October). The amount is equal to four percent of the total compensation paid to the payee during the calendar year (\$30,000 x 4%).

**Example 4.** A payer pays a payee \$6,000 compensation in November 2020. The payer should have withheld \$240 from the compensation (\$6,000 x 4%); however, the payer actually withheld \$300 from the compensation. The payer discovers the error in December 2020 after remitting the \$300 of withholding to the Department. The payer will not pay any additional compensation to the payee during 2020.

The payer may not refund the amount of tax withheld in error to the payee. The payer must include the full amount of tax withheld and remitted to the Department on the annual statement (\$300). The payee must file an income tax return and claim credit for the tax withheld.

**f. Examples of required withholding from compensation paid to a nonresident contractor for certain services performed in North Carolina**

The following are examples of when State taxes should be withheld from compensation paid to a nonresident contractor for services performed in North Carolina:

**Example 1.** A nightclub owner enters into a contract with a nonresident agent to provide entertainment at the owner’s club. Compensation is paid directly to the agent.

If the agent is an individual, tax is required to be withheld from the payment only to the extent the agent performed services in North Carolina. If the agent is a nonresident entity (LLC, partnership, corporation, etc.), tax must be withheld because the entity is deemed to be doing business in North Carolina through the entertainer. In either case, the agent is responsible for withholding 4% from the compensation paid to the entertainer because the entertainer is providing a personal service for the agent.

**Example 2.** The same nightclub owner from Example 1 enters into a contract with a nonresident agent to locate an entertainer and also enters into a separate contract with the entertainer, who is a nonresident individual.

The compensation paid to the agent is not subject to withholding unless the agent performs services in North Carolina. However, the club owner must withhold from the compensation paid to the entertainer.

**Example 3.** A coliseum rents its facility to a resident promoter who has contracted with a nonresident performer for a concert at the coliseum. The coliseum deducts rent and other fees and expenses from the gross ticket proceeds before payment to the promoter. The promoter compensates the nonresident performer for the performance.

No withholding is required from the ticket proceeds paid to the promoter because the promoter is a resident of North Carolina. The promoter is required to withhold the tax from the compensation paid to the nonresident performer because the performer is providing a personal service for the promoter.

## 5. Employee's Withholding Allowance Certificate

### a. General

Each new employee, before beginning employment, shall give the employer a signed [Form NC-4](#) or [Form NC-4 EZ](#), North Carolina Employee's Withholding Allowance Certificate. An employee that is a nonresident alien employee shall provide a signed [Form NC-4 NRA](#), Nonresident Alien Employee's Withholding Allowance Certificate, in lieu of Form NC-4 or Form NC-4 EZ.

The Department will allow an employer to establish a system for its employees to file North Carolina Employee's Withholding Allowance Certificates, Form NC-4, Form NC-4 EZ, or Form NC-4 NRA (if applicable), electronically if the employer is also using the system for federal form W-4s, Employee's Withholding Allowance Certificates. A certificate filed by a new employee is effective upon the first payment of wages after it is filed and remains in effect until the employee furnishes a new certificate unless the employee claimed total exemption from withholding during the prior year.

Employees claiming exemption from withholding must provide the employer a new Form NC-4EZ by February 15 each year. State and federal definitions of single person, married, head of household, and surviving spouse are the same; however, the number of allowances to which an individual is entitled may differ. **Federal Withholding Certificates are not acceptable.** If an employee fails to furnish a withholding allowance certificate, Form NC-4 or Form NC-4 EZ, the employer must withhold tax as if the employee is single with zero allowances.

The employer is not required to ascertain whether or not the total amount of allowances claimed is greater than the total number to which the employee is entitled. However, if the



employer has reason to believe that the number of allowances claimed by an employee is greater than the number to which such employee is entitled, the employer must notify the Department of Revenue at the time for filing the quarterly report for the quarter during which the certificate is received, if the employer files quarterly withholding reports. If the employer files monthly withholding reports, the employer shall notify the Department of certificates received during the quarter at the time for filing the monthly report for the third month of the quarter.

If an employee's allowances should decrease, requiring more tax to be withheld, the employee must provide an amended certificate to the employer within 10 days after the change. Should the allowances increase, requiring less tax to be withheld, the employee may provide an amended certificate to the employer at any time after the change occurs.

*Reference:* [G.S. § 105-163.5](#); [17 NCAC 06C .0123](#); [17 NCAC 06C .0126](#).

#### **b. Nonresident Alien Employee's Withholding Allowance Certificate, Form NC-4 NRA**

Because nonresident aliens are generally not allowed a standard deduction, nonresident alien employees must complete and sign a North Carolina Nonresident Alien Employee's Withholding Allowance Certificate, [Form NC-4 NRA](#). Nonresident alien employees must withhold tax using the "Single" filing status regardless of the employee's actual marital status. If an employee does not provide the employer with a completed NC-4 NRA, the employer must withhold as single with zero allowances and also withhold the additional tax as directed below.

In addition to claiming the proper number of allowances on line 1 of [Form NC-4 NRA](#), a nonresident alien employee must complete line 2 to identify the amount of additional tax to be withheld from each pay period's wages. The additional amount per pay period is given in the tables contained in both [Form NC-4 NRA](#) and in [Publication NC-30](#). Students and business apprentices who are residents of India and subject to the U.S.-India tax treaty may enter \$0 on line 2.

Employers should limit the additional withholding to the lesser of the amount reported by the employee on line 2 or 5.35% of the wages for the period if the amount of wages for that period multiplied by the number of payroll periods during the year is less than the standard deduction for single filers. The Department provides a chart to assist employers with this calculation in [Publication NC-30](#).

*Reference:* [G.S. § 105-163.5](#); [17 NCAC 06C .0123](#); [17 NCAC 06C .0126](#).

## **6. Additional Withholding Allowances**

Withholding allowances may be claimed by taxpayers expecting to have allowable itemized deductions exceeding the standard deduction or allowable adjustments to income. Additional allowances may be claimed for each \$2,500 that the N.C. itemized deductions are expected to exceed the standard deduction and for each \$2,500 of adjustments reducing income.

Additional allowances may also be claimed if the taxpayer is entitled to a tax credit. The number of additional allowances is determined by dividing the amount of the tax credit by the product determined by multiplying the withholding tax rate by \$2,500 and then rounding that number down to the nearest whole number. The withholding tax rate is the individual income tax rate plus one tenth of one percent (0.1%). For 2021, the individual income tax rate is 5.25% so the withholding tax rate is 5.35%.

*Reference:* [G.S. § 105-163.5](#); [17 NCAC 06C .0124](#).

## **7. Penalty for Unreasonable Allowance Certificate**

[G.S. § 105-163.5](#) provides a civil penalty against an employee who gives an employer an allowance certificate that contains information which has no reasonable basis and results in a lesser amount of tax being withheld than would have been withheld had the employee provided reasonable information. The penalty is 50% of the amount not properly withheld.

## **8. Submission of Certain Withholding Allowance Certificates**

An employer is required to submit a copy of any withholding allowance certificate on which the employee claims more than 10 withholding allowances or claims exemption from withholding and the employee's wages per week would normally exceed an amount equal to the North Carolina standard deduction for an individual with a filing status of single divided by 52. For tax year 2021, that amount is \$206.73.

An employer filing a quarterly withholding report shall submit copies of the certificates received during the quarter when the quarterly report is filed. An employer filing monthly withholding reports shall submit copies of the certificates received during the quarter at the time for filing the monthly report for the third month of the calendar quarter.

Copies may be submitted earlier and for shorter reporting periods. Copies of the certificates, along with a letter showing the employer's name, address, withholding identification number, and the number of certificates submitted, should be mailed to the Department.

The employer shall withhold on the basis of the certificate until written notice is received from the Department that the certificate is defective. As part of that written notice, the Department will advise the employer to ignore the allowance certificate filed and to withhold using the number of allowances specified. The employer shall furnish the employee a copy of the written notice upon receipt.

If the employee files a new certificate, the employer must honor that certificate only if the employee does not claim exempt and claims a number smaller than the number allowed in the Department's written notice. If the new certificate claims a number larger than the employee has been allowed and the employee specifies, in writing, any circumstances as justification to support the claims, the employer must, upon receipt, forward a copy of the certificate and the employee's written statement to the Department for review. The employer must continue to

withhold as specified in the Department's written notice until written notice is received from the Department advising the employer to withhold on the basis of the new certificate.

To increase withholding, an employee may claim less than the employee's allowable allowances or may enter into an agreement with the employer and request that an additional amount be withheld by entering the desired amount on [NC-4](#), [NC-4 EZ](#), or [NC-4 NRA](#).

An employee working for two or more employers should claim the employee's allowable allowances with only one employer and claim zero allowances with the other employers.

*Reference:* [17 NCAC 06C .0126](#).

## 9. Employers

An employer is any person or organization for whom an individual performs any service as an employee or any person or organization that pays wages for any reason. The term includes federal, state, and local governmental agencies as well as religious, charitable, educational, and other nonprofit organizations even though they may be exempt for other tax purposes.

**Note:** Compliance with any of the provisions of North Carolina withholding by a nonresident employer will not be deemed to be evidence that the nonresident is doing business in this State. (See [G.S. § 105-163.4](#))

*Reference:* [G.S. § 105-163.1](#).

## 10. Employees

### a. General

For North Carolina income tax withholding purposes, an employee is either a resident individual legally domiciled in this State who performs services within or outside North Carolina for wages, or a nonresident of this State who performs services within the State for wages. For the purposes of this section, the location of the services performed by the employee is determined by the physical location at which the employee performs the services.

**Example:** Employer is located in North Carolina and hires Employee A as a full time remote teleworker. Employee A is a resident of Virginia. Employee A will perform all job duties in Virginia.

Employer is not required to withhold North Carolina income tax from the wages of Employee A because Employee A is not a resident of North Carolina and Employee A will not perform services within North Carolina.

**Important:** As of the date of this publication, notwithstanding the COVID-19 pandemic, North Carolina has not changed withholding tax law regarding remote workers. For additional information, see [State Tax Relief for Employers](#).

## **b. Tax Credits**

To prevent double withholding and to anticipate any tax credits allowable to a North Carolina resident, withholding of North Carolina tax is not required from wages paid to a resident for services performed in another state if that state requires withholding. This relief from double withholding does not relieve the resident of the obligation to file a [Form D-400](#), North Carolina individual income tax return, and pay any balance due after receiving credit for taxes paid to the other state.

All wages received by a nonresident for services performed in this State are subject to withholding of North Carolina income tax. Any relief from double withholding must be granted by the nonresident's state of residence.

**Example 1:** Employer is located in South Carolina and hires Employee A to work at Employer's location in South Carolina. Employee A is a resident of North Carolina and commutes to South Carolina each day to work.

Employer is not required to withhold North Carolina income tax from the wages of Employee A. Even though Employee A is a resident of North Carolina, Employee A is performing all services that require withholding for Employer in South Carolina. Because Employee A is a resident of North Carolina, Employee A has an obligation to file a North Carolina individual income tax return and must pay any tax due after receiving a credit for income taxes paid to South Carolina.

**Example 2:** Employer is located in Georgia and hires Employee A as a full time remote teleworker. Employee A is a resident of North Carolina. Employee A will perform all job duties entirely from Employee A's home in North Carolina.

Employer is required to withhold North Carolina income tax from the wages of Employee because Employee is a resident of North Carolina and performs services for Employer in North Carolina. Employer is not eligible for a tax credit for any withholding taxes owed to Georgia because Employee A's services were not performed in Georgia.

For more information, see [Credit for Income Tax Paid to Another State or Country](#).

*Reference:* [G.S. § 105-163.1](#); [17 NCAC 06C .0107](#).

## **11. Employer-Employee Relationship**

Everyone who performs services subject to the will and control of an employer, both as to what shall be done and how it shall be done, is an employee. An employer-employee relationship exists when the person for whom the services are performed has the right to control and direct the individual performing the services. Managers and other supervisory personnel, officers of corporations, and elected public officials are employees. Whether the employer actually controls and directs the manner in which the services are performed does not matter if the employer has the right to do so, and it does not matter that the employee is called by some

other name such as partner, agent, or independent contractor; nor whether the individual works full or part time; nor how the payments are measured, paid, or what they are called.

Lawyers, physicians, contractors, and others who follow an independent trade, business, or profession in which they offer their services to the public, generally are not employees. If an individual is subject to the control and direction of another only as to the results of the individual's work and not as to the methods of accomplishing the results, the individual is generally an independent contractor and not an employee.

*Reference:* [17 NCAC 06C .0108](#).

## **12. Ministers**

An ordained or licensed clergyman who performs services for a church of any religious denomination may file an election with the Secretary of Revenue and the church he serves to be considered an employee of the church instead of self-employed. Until a clergyman files the election, amounts paid by a church to a clergyman are not subject to withholding.

*Reference:* [G.S. § 105-163.1A](#).

## **13. Common Carriers**

The Amtrak Reauthorization and Improvement Act of 1990 provides that no part of the compensation paid to an employee of an interstate railroad subject to the jurisdiction of the Surface Transportation Board (STB) may be subject to income tax, or income tax withholding, in any state except the state of the employee's residence when such employee performs regular assigned duties in more than one state. The Act also precludes the taxation of compensation paid by an interstate motor carrier subject to the jurisdiction of the STB or to an employee of a private motor carrier performing services in two or more states except by the state of the employee's residence. Therefore, the compensation received by such nonresident employees for services performed in this State will not be subject to North Carolina income tax or income tax withholding.

Under the Federal Aviation Act (49 U.S.C. § 40116), a nonresident airline employee rendering services on an aircraft would not be liable for North Carolina income tax unless the scheduled flight time in North Carolina is more than 50% of the total scheduled flight time during the calendar year. If the employee's flight logs show that more than 50% of the scheduled flight time is in North Carolina, the amount of income reportable to this state would be based on the percentage that the North Carolina flight time is to the total flight time for the year.

## **14. Federal Employees**

Under an agreement with this State, federal agencies withhold North Carolina income tax from the military pay of members of the Armed Forces designated as legal residents of North

Carolina, and from the pay of civilian federal employees whose regular place of employment is in North Carolina.

## 15. Military Spouses

Under the Servicemembers Civil Relief Act, the wages of a spouse of a military servicemember who is legally domiciled in a state other than North Carolina are exempt from North Carolina income tax if:

- (a) the servicemember is present in North Carolina solely in compliance with military orders;
- (b) the spouse is in North Carolina solely to be with the servicemember; and
- (c) the spouse is domiciled in the same state as the servicemember.

For tax years beginning on or after January 1, 2018, the Veterans Benefits and Transition Act of 2018 amended the Servicemembers Civil Relief Act to allow the spouse of a servicemember to [elect to use the same residence as the servicemember](#) for state tax purposes.

Therefore, if a military spouse meets all three of the preceding conditions, an employer is not required to withhold North Carolina tax from wages paid to such military spouses. The military spouse shall furnish to the employer [Form NC-4 EZ](#), North Carolina Employee's Withholding Allowance Certificate, certifying that the spouse is not subject to North Carolina withholding because the conditions for exemption have been met. The military spouse shall certify the state of domicile and attach a copy of the spousal military identification card and a copy of the servicemember's most recent leave and earnings statement to [Form NC-4 EZ](#).

The Act does not exempt military spouses who are domiciled in North Carolina from North Carolina income tax withholding. Withholding from wages paid to military spouses domiciled in North Carolina is still required. For more information, see [Active Military](#).

## 16. Seamen

The Vessel Worker Tax Fairness Act, 46 U.S.C. § 11108, prohibits withholding of state income tax from the wages of a seaman on a vessel engaged in foreign, coastwise, intercoastal, interstate, or noncontiguous trade or an individual employed on a fishing vessel or any fish processing vessel. Vessels engaged in other activity do not come under the restriction; however, any seaman who is employed in coast wide trade between ports in this State may have tax withheld if such withholding is pursuant to a voluntary agreement between such seaman and his employer.

With respect to income obtained while: (1) engaged as a pilot (licensed under section 7101 of Title 46 of the Code or under the laws of a state) on a vessel performing duties in more than one state; or (2) performing regularly assigned duties as a master, officer or crewman on a vessel operating on the navigable waters of more than one state, an individual is subject to income tax only in the state in which the individual resides.

Seamen who are exempt from withholding as specified above, should determine whether they meet the requirements for making payments of estimated income tax.

*Reference:* [17 NCAC 06C .0112](#).

## **17. Professional Athletes**

Professional athletic teams must withhold income tax from the North Carolina source income of a nonresident member of the team at the rate for individuals with no withholding allowances. (See [Tax Rates](#) for a schedule of North Carolina tax rates.) Taxes shall be withheld from the income of a resident member of the team in the same manner as taxes are withheld from other residents.

Professional athletic teams not domiciled in this State are classified as quarterly employers and must file returns reporting the amount of taxes withheld and pay the amounts withheld on a quarterly basis.

Professional athletic teams that are domiciled in this State shall determine their filing and paying requirements in the same manner as all employers domiciled in this State.

A nonresident member of a professional athletic team is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the compensation received for services rendered as a member of the team and the team has met the withholding requirements above. The individual may file an individual income tax return and claim credit for the tax withheld.

The professional athletic team, as well as the individual, shall be personally and individually liable for any additional tax due if the professional athletic team does not properly determine the individual's North Carolina source income or properly withhold tax from that income. The Department will not collect the additional tax, penalty, or interest due twice.

*Reference:* [17 NCAC 06B .3905](#).

## **18. Domestic/Household Employees**

Employers are not required to withhold State income tax from the wages of domestic/household employees; however, the employer and employee may enter into a voluntary agreement to withhold from the employee's wages. The amount to withhold is based on the employee information shown on [Form NC-4](#) or [Form NC-4 EZ](#), North Carolina Employee's Withholding Allowance Certificate. Employers may wish to contact the Division of Employment Security regarding any employment insurance liability.

## **19. Farm Labor**

Compensation paid by a farmer for services performed on the farmer's farm in producing or harvesting agricultural products or in transporting the agricultural products to market is subject to North Carolina withholding.

Wages paid to agricultural workers are subject to North Carolina withholding to the same extent federal income tax withholding is required. Generally, wages paid to agricultural workers are subject to federal income tax withholding if the worker is paid \$150 or more during the year or the employer pays \$2,500 or more to all agricultural workers during the year.

Compensation paid to agricultural workers who are ITIN holders is also subject to North Carolina withholding. For more information, refer to [Withholding from Non-Wage Compensation](#). **Note:** An exception exists for aliens commonly referred to as H-2A agricultural workers.

## 20. North Carolina State Lottery Winnings

Winnings of \$600 or more paid by the North Carolina State Lottery Commission are subject to State withholding at the rate of 5.25% for tax year 2021.

*Reference:* [G.S. § 105-163.2B](#).

## 21. Supplemental Wage Payments

If an employer pays supplemental wages separately (or combines them with regular wages in a single payment and specifies the amount of each), the income tax withholding method depends on whether the employer withholds income tax from the employee's regular wages and whether the wages and supplemental wages are paid in a single payment. If the employer withholds income tax from an employee's regular wages, the employer can use one of the following methods for the supplemental wages:

- (a) Withhold a flat 5.35% for tax year 2021, or
- (b) Add the supplemental and regular wages for the most recent payroll period and then figure the income tax as if the total were a single payment. Subtract the tax already withheld from the regular wages and withhold the remaining tax from the supplemental wages.

**Note:** If the employer does not withhold income tax from the employee's regular wages, use method (b).

Vacation pay is subject to withholding as if it were a regular wage payment. If vacation pay is paid in addition to the regular wages, treat the vacation pay as supplemental wages. If vacation pay is for a time longer than an employer's usual payroll period, spread it over the pay periods for which it is paid.

**Tips treated as supplemental wages.** The employer shall withhold the income tax on tips from wages or collect the tax from funds the employee provides. If an employee receives regular wages and reports tips, the employer shall figure income tax as if the tips were supplemental wages. If the employer has not withheld income tax from the regular wages, the employer adds the tips to the regular wages and withholds income tax on the total. If the



employer withheld income tax from the regular wages, the employer can withhold on the tips as previously explained.

*Reference:* [17 NCAC 06C .0117](#).

## **22. Wage and Tax Statements**

An employer should use the six-part federal Form W-2 or any other alternate forms which have been designed for payroll equipment if they provide the same information and the same number of copies as the official form. When completed, the state copies must show the employer's North Carolina withholding identification number and must clearly designate the state tax as North Carolina tax. Statements which do not meet the above requirements will not be accepted and employees cannot be given credit for the tax withheld.

*Reference:* [17 NCAC 06C .0119](#).

## **23. Reciprocity of Tax Credits**

North Carolina does not allow an income tax credit for taxes paid to another state to nonresidents; therefore, any relief from double taxation must be granted by the state of residence. North Carolina provides such relief to its residents.

*Reference:* [17 NCAC 06C .0120](#).

## **24. Credit for Income Tax Withheld**

[G.S. § 105-163.10](#) provides that the amount deducted and withheld during any calendar year from the compensation of any individual must be allowed as a credit to that individual against the tax imposed under [G.S. § 105-153.7](#) for taxable years beginning in such calendar year. For example, a taxpayer filing his return for a fiscal year ending September 30, 2021, will be allowed credit for tax withheld from wages for the calendar year ending December 31, 2020. This is the case even though the taxpayer must report the income on the return for the fiscal year ending September 30, 2021.

## XII. Reporting and Paying Tax Withheld

### 1. New Withholding Agents, including Employers, Pension Payers, and Other Payers

Each new withholding agent who is required to or voluntarily withholds North Carolina income tax must register [on the Department's website](#) or complete and file [Form NC-BR](#), Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery and Equipment Tax. The Department will assign a State withholding identification number which should be used on all reports, returns, and correspondence concerning withholding. Do not use the number of another taxpayer from whom a business was acquired.

*Reference:* [17 NCAC 06C .0201](#).

### 2. Reports and Payments

North Carolina does not use a deposit system for income tax withheld similar to the federal system. Withheld taxes are paid quarterly, monthly, or semiweekly. Taxpayers who withhold an average of less than \$250 from wages, non-wage compensation, and pensions each month must file a quarterly return and pay the withheld taxes on a quarterly basis. The quarterly return and payment are due by the last day of the month following the end of the calendar quarter.

Taxpayers who withhold an average of at least \$250 but less than \$2,000 from wages, non-wage compensation, and pensions each month must file a monthly return and pay the withheld taxes on a monthly basis. All monthly returns and payments are due by the fifteenth day of the month following the month in which the tax was withheld; except the return and payment for the month of December are due to be filed on or before January 31.

Taxpayers who withhold an average of at least \$2,000 from wages, non-wage compensation, and pensions each month must file a report and pay the withheld taxes at the same time they are required to file reports and pay the tax withheld on the same wages, non-wage compensation, and pensions for federal income tax purposes. The due dates for reporting and paying North Carolina income tax withheld are determined by the due dates for depositing federal employment taxes (income tax withheld and FICA). Each time a taxpayer is required to deposit federal employment taxes, the taxpayer must remit the North Carolina income tax withheld on those same wages, non-wage compensation, and pensions, regardless of the amount of State tax withheld.

**Exception.** For federal tax purposes, if a taxpayer withholds \$100,000 or more, the deposit is required on the next banking day. North Carolina did not adopt this provision of federal law, and the State income tax withholding on the same wages, non-wage compensation, and pensions is due on or before the normal federal semiweekly due date for those wages, non-wage compensation, and pensions. The taxpayer must mail or deliver payment of the North Carolina income tax withheld by the due date.

Semiweekly filers are required to reconcile the tax paid with the tax withheld for the quarter on [Form NC-5Q](#), Quarterly Tax Withholding Return. The due dates for Form NC-5Q are the same as for the federal quarterly return (federal Form 941). A taxpayer has 10 additional days to file the return if all required payments were made during the quarter and no additional tax is due. A taxpayer reconciles the tax paid and the tax withheld for the year by filing [Form NC-3](#), Annual Withholding Reconciliation. Form NC-3 is due to be filed on or before January 31 following the end of the tax year. If a taxpayer terminates its business, the taxpayer must file Form NC-3 within 30 days of the date on which the taxpayer closed the business. For information on when a document is considered timely filed, see [Departmental Directive TA-16-1](#) and [Departmental Directive TA-18-1](#).

*Reference:* [G.S. § 105-163.6](#).

### **3. E-File**

Taxpayers can file their North Carolina withholding returns and pay their taxes online by using the Department's [Online Filing and Payments](#) portal. The E-file system is available 24 hours a day, 7 days a week. Payments can be made by bank draft (no convenience fee) or credit or debit card using Visa or MasterCard (convenience fee).

### **4. Electronic Funds Transfer**

The Department requires certain taxpayers remitting an average of \$20,000 per month per tax type to pay taxes by electronic funds transfer (EFT). Taxpayers required to remit payments by this method will be notified in writing at least 60 days prior to the first month that an EFT payment is due. Voluntary participation is offered for all filing frequencies for non-mandated taxpayers who are interested in paying electronically. For questions concerning electronic funds transfer, contact the EFT Unit at 1-877-308-9103.

*Reference:* [G.S. § 105-241\(b\)\(3\)](#).

### **5. Amounts Withheld Are Held in Trust for the Secretary of Revenue**

Any amount of North Carolina income tax withheld by a taxpayer is deemed to be held in trust for the Secretary of Revenue.

A penalty of 10% of the amount due is imposed for failure to withhold or to pay the tax when due. The penalty for failure to timely file a withholding return is 5% of the tax due per month (maximum 25%). In addition, criminal penalties are provided for willful failure to comply with the withholding statutes.

A taxpayer who fails to withhold or pay the amount required to be withheld is personally and individually liable for the tax, including any penalties and interest due. If a taxpayer has failed to withhold or to pay over income tax withheld or required to have been withheld, the unpaid principal amount of tax may be assessed against the responsible persons of the taxpayer.

More than one person may be liable as a person responsible for the payment of withholding taxes; however, the amount of the income tax withheld or required to have been withheld shall be collected only once, whether from the taxpayer or one or more responsible persons. The term “responsible person” means the president, treasurer, or chief financial officer of a corporation; a manager of a limited liability company or a partnership; any officer of a corporation, a member or company official of a limited liability company, or a partner in a partnership who has a duty to deduct, account for, or pay over income tax withheld or required to be withheld; or a partner who is liable for the debts and obligations of a partnership under [G.S. § 59-45](#) or [G.S. § 59-403](#). It is not necessary that the failure to collect and pay the withholding amounts was willful; it is only necessary that the responsible person failed to pay the tax withheld or required to have been withheld to the Secretary of Revenue. When the Department of Revenue determines that collection of the tax is in jeopardy, a taxpayer may be required to report and pay the tax at any time after payment of the wages, non-wage compensation, and pensions.

*Reference:* [G.S. § 105-163.8](#); [17 NCAC 06C .0204](#); [G.S. § 105-242.2](#).

## 6. Annual Reports

### a. Informational Returns to Secretary

#### 1. Form NC-3.

Employers and other payers that are required to or voluntarily withhold North Carolina income taxes must electronically file [Form NC-3](#), Annual Withholding Reconciliation. For tax year 2020, as a part of Form NC-3 filing requirement, the following forms or statements are required to be electronically filed with the Department if they report North Carolina income tax withholding or meet the Internal Revenue Service’s information return reporting thresholds:

Form	Required to file if NC withholding reported?	Required to file if <u>no</u> NC withholding reported?
W-2	Yes	Yes, if issued to NC resident or issued to non-resident for services performed in NC
W-2G	Yes	No, if reported to the IRS
1099-MISC	Yes	No
1099-NEC	Yes	No
1099-R	Yes	Yes, if recipient’s address is located in NC
1099-B	Yes	No, if reported to the IRS
1099-DIV	Yes	No, if reported to the IRS
1099-INT	Yes	No, if reported to the IRS
1099-OID	Yes	No, if reported to the IRS
1099-G	Yes	No, if reported to the IRS
1042-S	Yes	Yes, if it includes NC source income
NC-1099M	Yes	No, if reported to the IRS on federal Form 1099-MISC or 1099-NEC

If an employer or other payer terminates its business in 2021, the employer or other payer should follow the guidance provided for 2020 Form NC-3 and required W-2 and 1099 statements.

**Note:** For non-wage compensation paid to a payee on or after January 1, 2020, the non-wage compensation must be reported on the new North Carolina Form NC-1099M, Compensation Paid to a Payee. If an employer or other payer is required to complete a federal Form 1099-MISC or federal Form 1099-NEC to report the non-wage compensation paid to a payee, the employer or other payer is not required to complete Form NC-1099M. For additional details about withholding from compensation paid to a payee, see [Withholding from Non-Wage Compensation](#).

## 2. Due Date.

Form NC-3 and the required W-2, 1099, and 1042-S statements (collectively “Form NC-3”) must be filed on or before January 31 of the following calendar year and in an electronic format as prescribed by the Secretary. If an employer or other payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed within 30 days of the date on which the employer or other payer closed the business.

## 3. Informational Return Penalties.

Pursuant to [G.S. § 105-236\(a\)\(10\)](#), the penalty for failure to timely file an informational return by the due date is \$50 per day, up to a maximum of \$1,000. Starting with the filings for tax year 2019, a request to waive the failure to timely file an informational return penalty will affect a payer’s good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department’s [Penalty Waiver Policy](#)) allows every taxpayer one penalty waiver for most tax types every three years.

The penalty for failure to file the informational return in the format prescribed by the Secretary is \$200. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State’s copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the [eNC3 and Information Reporting Application](#) located on the Department’s website. **Note:** For tax year 2020, the Secretary elected to continue the automatic waiver of the penalty for failure to file Form NC-3 in the format prescribed by the Secretary. For more information, see the Department’s [Important Notice dated October 2, 2020](#).

For additional information on the eNC3 and Information Reporting Application including step-by-step guidelines on how to use the eNC3 and Information Reporting Application, see the [eNC3 webpage](#) located on the Department’s website. The eNC3 webpage includes additional information such as frequently asked questions and examples of when an employer or other payer may be subject to the informational return penalties.

#### 4. Other Information Returns of Payers

Pursuant to [G.S. § 105-154\(b\)](#), a person who is a resident of North Carolina, has a place of business in North Carolina, or has an employee, agent, or another representative in any capacity in North Carolina is required to file an information return as required by the Secretary if the person directly or indirectly pays or controls the payment of any income to any taxpayer. The return must contain all the information required by the Secretary. For purposes of this report, a person is defined as an individual, a fiduciary, a firm, an association, a partnership, a limited liability company, a corporation, a unit of government, or another group acting as a unit.

For purposes of this filing requirement, a person is required to file the following forms or statements with the Department:

Form	Filing Requirement*
W-2	Yes, if issued to NC resident or issued to non-resident for services performed in NC
W-2G	No, if reported to the IRS
1099-MISC	No
1099-R	Yes, if recipient's address is located in NC
1099-B	No, if reported to the IRS
1099-DIV	No, if reported to the IRS
1099-INT	No, if reported to the IRS
1099-OID	No, if reported to the IRS
1099-G	No, if reported to the IRS
1042-S	Yes, if it includes NC source income
NC-1099M	No, if reported to the IRS on federal Form 1099-MISC or 1099-NEC

\* If the abovementioned form or statement reports North Carolina income tax withholding, the form or statement must be filed with the Department.

Importantly, a person that is not required to file Form NC-3 should not apply for a withholding number with the Secretary and should not file a Form NC-3. Instead, the required information should be reported to the Secretary via the eNC3 and Information Reporting Application. For additional information on the eNC3 and Information Reporting Application, see the [eNC3 webpage](#) located on the Department's website.

**Informational Return Penalties:** A person that is not required to file Form NC-3 but is required to provide the Secretary with income information pursuant to G.S. § 105-154(b) is not subject to the informational return penalties prescribed in G.S. § 105-236(a)(10).

**b. Report to Employee, Contractor, Pension Payment Recipient, or Other Income Recipient**

Every employer and other payer who is required to or voluntarily withholds North Carolina income taxes from wages, non-wage compensation, or pension payments must furnish the recipient of the income a form or statement that reports certain information required by North Carolina law. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if an employer or other payer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For purposes of this filing requirement, a person is required to report the following information to the recipient of the income:

- 1. Report to Employee:** Employers must furnish two copies of the wage and tax statements, Form W-2, to employees from whom North Carolina income tax was withheld. The Internal Revenue Service supplies a six-part Form W-2 which will produce the required federal and North Carolina statements in one packet.
- 2. Report to Payee:** Effective January 1, 2020, a payer is required to withhold North Carolina income tax of four percent (4%) from non-wage compensation paid to a payee. For the definition of the term “payee” and other details, see [Withholding from Non-Wage Compensation](#).

A payer who withholds from compensation paid to a payee must provide the payee a statement showing the total compensation paid and the amount of North Carolina income tax withheld during the calendar year. The payer must give Form NC-1099M, Compensation Paid to a Payee, to the payee. Federal Form 1099-MISC or Form 1099-NEC may be provided in lieu of Form NC-1099M.

- 3. Report to Pension Payment Recipient:** A payer who withholds from pension income must give the recipient federal Form 1099-R, showing the pension amount paid and the North Carolina income tax withheld.
- 4. Report to Other Income Recipients:** A payer who withholds North Carolina income tax from any other income recipients must provide the recipients with the appropriate form or statement that reports identifying information of the payer and recipient, total amount of income payments, and the amount of North Carolina income tax withheld from the income payments.

*Reference:* [G.S. § 105-154](#); [G.S. § 105-163.2B](#); [G.S. § 105-163.3](#); [G.S. § 105-163.7](#); [G.S. § 105-236\(a\)\(10\)](#); [G.S. § 105-228.90](#); [17 NCAC 06C .0203](#).

## XIII. Statute of Limitations

### 1. General

The law contains certain time limitations, generally referred to as the “statute of limitations.” An income tax return from which information required to calculate the taxpayer’s income tax liability has been omitted is not a return for the purpose of determining the applicable statute of limitations. The date the return which contains sufficient information upon which to determine the tax liability is filed is the determining date.

For more information on the statute of limitations, see [G.S. § 105-241.8](#) and [G.S. § 105-241.9](#).

### 2. Statute of Limitations for Refunds

The Department of Revenue will refund an individual income tax overpayment of \$1.00 or more if the statute of limitations has not expired. A refund of less than \$1.00 will not be made unless the taxpayer files a written request for a refund. The general statute of limitations for filing a claim for refund of overpayment of taxes is three years after the due date of the return or two years after payment of the tax, whichever is later. The following exceptions apply:

- (a) If a taxpayer files a timely return reflecting a [federal determination](#), the period of time for requesting a refund is one year after the return reflecting the federal determination is filed or three years after the original return was filed or due to be filed, whichever is later.
- (b) A taxpayer’s waiver of the statute of limitations for making a proposed assessment extends the period in which the taxpayer can obtain a refund to the end of the period extended by the waiver.
- (c) For overpayments attributable to worthless debts or securities, the period of time for demanding a refund is seven years.
- (d) For overpayments attributable to capital loss and net operating loss carrybacks, the period of time for demanding a refund is three years from the due date of the return for the year in which the loss was incurred rather than three years from the due date of the return for the year to which the loss is carried back.
- (e) Overpayments attributable to a contingent event. [G.S. § 105-241.6\(b\)\(5\)](#) provides an exception to the general statute of limitations for obtaining a refund of an overpayment due to a contingent event. The statute addresses the following types of contingent events whereby the general statute of limitations for refunds may be extended once:

- (1) **Litigation or State Tax Audits.** If a taxpayer is subject to litigation or a state tax audit that prevents the taxpayer from filing an accurate and definite request for a refund of an overpayment within the period under [G.S. § 105-241.6](#), the period to request a refund of an overpayment is six months after the litigation or state tax audit concludes.



The taxpayer must file written notice to the Secretary prior to expiration of the statute of limitations under [G.S. § 105-241.6](#). The notice must identify and describe the litigation or state tax audit, identify the type of tax, list the return or payment affected, and state in clear terms the basis for and an estimated amount of the overpayment.

- (2) **Other Events.** If a taxpayer contends that an event, other than litigation or a state tax audit, has occurred that prevents the taxpayer from filing an accurate and definite request for a refund of an overpayment within the period under [G.S. § 105-241.6](#), the taxpayer may submit a written request to the Secretary seeking an extension of the statute of limitations. The taxpayer must file a written request to the Secretary prior to expiration of the statute of limitations under [G.S. § 105-241.6](#). The request must establish by clear, convincing proof that the event is beyond the taxpayer's control and prevents the taxpayer from timely filing an accurate and definite request for a refund of an overpayment. The Secretary's decision on the request is final and is not subject to administrative or judicial review.

For more information, see [Exception to the General Statute of Limitations for Certain Events](#).

*Reference:* [G.S. § 105-241.6](#); [G.S. § 105-241.7](#).

### 3. Protective Refund Claim

**The Department's protective refund claim policy was repealed effective January 1, 2014.** If you filed a protective refund claim prior to January 1, 2014, see [Exception to the General Statute of Limitations for Certain Events](#).

### 4. Statute of Limitations for Assessments

The general statute of limitations for proposing an assessment is three years after the due date of the return or three years after the return was filed, whichever is later. The following exceptions apply:

- (a) If a taxpayer files a timely return reflecting a [federal determination](#), the period of time for proposing an assessment of any tax due is one year after the return is filed or three years after the original return was filed or due to be filed, whichever is later. If there is a federal determination and a timely return is not filed, the period of time for proposing an assessment is three years after the date the Department received the final report of the federal determination.
- (b) If a taxpayer files an amended return with the Secretary as a result of filing a federal amended return and the return is filed within the time required pursuant to North Carolina law, the period for proposing an assessment of any tax due is one year after the return is filed or three years after the original return was filed or due to be filed, whichever is later. If the taxpayer does not file an amended return with the Secretary within the required time, the period for proposing an assessment of any tax due is three years after the due date of

the return or three years after the date the federal amended return was filed with the Commissioner of Internal Revenue, whichever is later. The date the federal amended return was filed is presumed to be the date recorded by the Internal Revenue Service. For more information on filing amended tax returns, see [Amended Returns](#).

- (c) If a taxpayer did not file a return, filed a fraudulent return, or attempted to fraudulently evade or defeat the tax, there is no statute of limitations and an assessment may be proposed at any time.
- (d) If a taxpayer, as a trustee, collects taxes on behalf of the State, but fails to remit all the taxes held in trust when due, the period for proposing an assessment is the later of:
  - (a) Ten years after the due date of the return.
  - (b) ten years after the taxpayer filed the return.
- (e) If a taxpayer forfeits a tax credit or tax benefit, the period of time for proposing an assessment of any tax due resulting from the forfeiture is three years after the date of the forfeiture.

There is no statutory provision prohibiting an assessment for a given year after an assessment has already been proposed for that year. Subsequent assessments can be made upon the discovery of new facts.

*Reference:* [G.S. § 105-241.8](#). [Session Law 2020-58](#).

## 5. Servicemembers in Combat Zones

An individual who is serving in the Armed Forces, or who is serving in support of the Armed Forces, in an area designated by the President as a combat zone, and who receives an extension of time to file his or her federal income tax return and receives relief from the accrual of penalty and interest as a result of serving in a combat zone or for being hospitalized as a result of wounds, disease, or injury sustained while serving in a combat zone, will receive the same extension of time for filing and the same relief from the accrual of penalty and interest for State income tax purposes.

In general, the following process is used to calculate the extended combat zone due date. First, determine the number of days left in the filing period when the taxpayer entered the combat zone. To determine the length of the extension period, the taxpayer adds 180 to this number. The extension period begins once the taxpayer returns from the combat zone. Note: If a taxpayer enters a combat zone after the due date for a filing period, the due date is not extended.

**Example 1:** Taxpayer seeks to determine the extended due date for the 2018 North Carolina individual income tax return. Taxpayer enters a combat zone on March 1, 2019. Taxpayer exits the combat zone on December 1, 2019.

When taxpayer entered the combat zone, there were 45 days remaining in the filing period. Adding 45 to 180, the taxpayer will receive a total extension of 225 days after returning

from the combat zone. Since the taxpayer returned from the combat zone on December 1, 2019, the 225 days extension extends the due date for the 2018 return until July 14, 2020.

**Example 2:** Taxpayer seeks to determine the extended due date for the 2018 North Carolina individual income tax return. Taxpayer enters a combat zone on November 1, 2019.

Because taxpayer did not enter the combat zone until after the due date for the 2018 return, the due date is not extended.

The compensation of a military or civilian employee of the United States who dies as a result of terroristic or military action is exempt from State income tax for the same periods for which the income is exempt for federal income tax purposes.

*Reference:* [G.S. § 105-249.2\(a\)](#)

## **6. Waiver of Time Limitation**

A taxpayer may make a written waiver of the limitations of time specified by law for assessing any tax or additional tax, for either a definite or indefinite period of time, and if such waiver is accepted, the Secretary of Revenue may propose an assessment at any time within the extended period. An agreement by a taxpayer to extend the time in which the Secretary of Revenue can assess the taxpayer automatically extends the period of time for refunds of overpayments by the taxpayer.

*Reference:* [17 NCAC 01C .0307](#).

## **XIV. Federal Determinations**

### **1. General**

Under [G.S. § 105-228.90\(b\)\(3a\)](#), a federal determination is defined as a change or correction arising from an audit by the Commissioner of Internal Revenue or an agreement of the U.S. competent authority, and the change or correction has become final. A federal determination is final when the determination is not subject to administrative or judicial review. In addition, audit findings are deemed final when (1) the taxpayer receives audit findings from the IRS for the tax period and the taxpayer does not timely file an administrative appeal with the IRS, or (2) the taxpayer consents to any of the audit findings for the tax period through a form or other written agreement with the IRS.

If a taxpayer's federal adjusted gross income, filing status, personal exemptions, standard deduction, itemized deductions, or federal tax credit are changed or corrected by the Internal Revenue Service or agreement of the U.S. competent authority, and the change or correction affects the amount of State tax payable, the taxpayer must file an income tax return reflecting each change or correction from a federal determination within six months after being notified of the change or correction.

*Reference:* [G.S. § 105-159](#); [G.S. § 105-241.6\(b\)\(1\)](#); [G.S. § 105-241.7](#); [G.S. § 105-241.8\(b\)\(1\)](#); [G.S. § 105-241.10](#); [G.S. § 105-228.90\(b\)\(3a\)](#); [S.L. 2019-169](#).

### **2. Refunds and Assessments after a Federal Determination**

#### **a. When a taxpayer timely files a return reflecting a federal determination**

When a taxpayer timely files a return reflecting a federal determination that affects the amount of State tax payable and the general statute of limitations for requesting a refund or proposing an assessment of the State tax has expired, the taxpayer is entitled to a refund or is liable for additional tax only if the refund or additional tax is the result of adjustments related to the federal determination.

The period for proposing an assessment of any tax due is one year after the return is filed or three years after the original return was filed or due to be filed, whichever is later.

#### **b. When a taxpayer does not timely file a return reflecting a federal determination**

If a taxpayer fails to report the federal determination within six months and the federal determination increases the amount of State tax payable, the taxpayer must pay a failure to file penalty of 5% of the additional tax for each month, or part of a month the federal changes are not reported to the Department of Revenue (maximum 25% of the additional tax).

The period for proposing an assessment of any tax due is three years after the date the Secretary receives the final report of the federal determination. If a taxpayer fails to report

the federal determination within six months and the change decreases the amount of State tax payable, the taxpayer forfeits the right to any refund due by reason of the federal determination.

*Reference:* [G.S. § 105-159](#); [G.S. § 105-241.6\(b\)\(1\)](#); [G.S. § 105-241.7](#); [G.S. § 105-241.8\(b\)\(1\)](#); [G.S. § 105-241.10](#); [G.S. § 105-228.90\(b\)\(3a\)](#); S.L. 2019-169.

### **3. Federal Determinations and Fraud**

When there is a federal determination and a fraud penalty is assessed by the federal government, the State may open the year on the basis of either fraud or the federal assessment. If a State return has not been filed, the 50% fraud penalty and the 5% per month (25% maximum) failure to file penalty may be assessed.

*Reference:* [G.S. § 105-236\(a\)\(6\)](#); [17 NCAC 06B .3206](#); [17 NCAC 06B .3404](#).

# XV. Appeals Process & Collection of Tax

## 1. General

Taxpayers who disagree with a proposed assessment of taxes or a denial or reduction to a request for refund filed within the statute of limitations for requesting a refund may request that the Department review that action by submitting [Form NC-242](#), Objection and Request for Departmental Review, to the Department. The request for review must be filed with the Department within 45 days from the date the notice was mailed by the Department (if mailed) or delivered to you (if delivered by a Department employee in person). For more information, see [Resolving Disputes about Your Taxes](#).

**Note:** An assessment for taxes shown due on a return but not paid or the application of refunds to debts owed to State and local government agencies or the Internal Revenue Service is not subject to the review process.

*Reference:* [G.S. § 105-241.11](#).

## 2. Denial of Refund Based on Statute of Limitations

If the Department denies a refund based on the Department's determination that the request for refund was filed outside of the statute of limitations for requesting a refund, there is no administrative review of that decision. The taxpayer may contest the Department's determination by filing a petition for a contested tax case hearing at the Office of Administrative Hearings in accordance with [Article 3 of Chapter 150B](#) of the General Statutes. The petition must be filed within sixty (60) days of the date of the notice of denial of refund. The sole issue to be decided by the administrative law judge is whether or not the statute of limitations bars the taxpayer's claim for refund of an overpayment. The final decision by the administrative law judge regarding the statute of limitations is subject to judicial review under [Article 4 of Chapter 150B](#) and under [G.S. § 105-241.16](#).

After judicial review, if the final decision is that the taxpayer's claim for refund is not barred by the statute of limitations, then the taxpayer's claim for refund is remanded to the Department for review of the substantive issues. Any remand is regarded as a new amended return or claim for refund timely filed within the statute of limitations under [G.S. § 105-241.7\(c\)](#). For more information, see the Department's [Important Notice dated July 13, 2016](#).

*Reference:* [G.S. § 105-241.7\(c1\)](#).

## 3. Collection of Tax

The Department may collect a tax in the following circumstances:

- (a) When a taxpayer files a return showing an amount due with the return and does not pay the amount shown due.

- (b) When the Department sends a notice of collection after a taxpayer does not file a timely request for a Departmental review of a proposed assessment of tax or based upon taxpayer inaction after timely filing a request for review in accordance with [G.S. § 105-241.13A](#).
- (c) When a taxpayer and the Department agree on a settlement concerning the amount of tax due.
- (d) When the Department sends a notice of final determination concerning an assessment of tax and the taxpayer does not file a timely petition for a contested case hearing on the assessment.
- (e) When a final decision is issued on a proposed assessment of tax after a contested case hearing.
- (f) When the Office of Administrative Hearings dismisses a petition for a contested case for lack of jurisdiction because the sole issue is the constitutionality of a statute and not the application of a statute.

*Reference:* [G.S. § 105-241.22](#).

#### **4. Servicemembers Civil Relief Act**

Certain sections of the Servicemembers Civil Relief are pertinent to matters of federal and state taxation. With respect to payment of income tax, the act provides for the deferment of payment of income tax for a period of 180 days after military service ends if the servicemember's inability to pay the tax was caused by military service. No penalty or interest shall accrue during the period of deferment.

## **XVI. Penalties and Interest**

### **1. COVID-19 Penalty and Interest Relief**

Because of the COVID-19 pandemic, state and federal governments offered both administrative and statutory tax relief to taxpayers. Information about this relief is provided in [COVID-19 Provisions](#).

### **2. General**

The North Carolina General Statutes provide both civil and criminal penalties for failure to comply with the income tax laws. The more common penalties are included below. For additional information, see [G.S. § 105-236](#). In addition to any applicable penalty, all assessments of taxes or additional taxes bear interest at the applicable rate from the due date until date of payment.

### **3. Failure to File and Failure to Pay Penalties**

Under the provisions of [G.S. § 105-236](#), both the late filing and late payment penalties can be applied for the same month. If the return is filed late with net tax due, both the late filing and late payment penalties will be assessed at the same time. “Net tax due” is the amount of tax required to be shown on the return less any timely payments of the tax and allowable credits.

Returns filed after the due date are subject to a failure to file penalty of 5% of the net tax due for each month, or part of a month, the return is late (maximum 25% of the additional tax). If the return is filed under an extension, the late filing penalty will be assessed from the extended filing date rather than from the original due date.

The late payment penalty is 10% of the tax not paid by the original due date of the return. If a timely extension is filed, the penalty will apply on any remaining balance due if the tax paid by the original due date of the return is less than 90% of the total amount of tax due. If the 90% rule is met, any remaining balance due, including interest, must be paid with the income tax return on or before the expiration of the extension period to avoid the late payment penalty. Interest is due from the original due date to the date paid.

The late payment penalty will not be assessed if the amount shown due on an amended return is paid with the return. Proposed assessments of additional tax due are subject to the 10% late payment penalty if payment of the tax is not received within 45 days of the assessment unless a timely Request for Departmental Review is filed. For more information on requests for reviews, see [Appeals Process](#).

*Reference:* [G.S. § 105-236; 17 NCAC 06B .3203](#).



#### **4. Large Tax Deficiency and Negligence Penalties**

When there is an understatement of taxable income equal to 25% or more of gross income, the 25% large individual income tax deficiency or other large tax deficiency penalty will be assessed. When the percentage of understatement of taxable income is less than 25%, the 10% negligence penalty may be applied. The application of the 10% negligence penalty is based on the understatement of tax and will be made on the basis of the facts in each case. When the accuracy penalty has been assessed for federal income tax purposes, the 10% negligence penalty will be assessed for State income tax purposes, unless the 25% large individual income tax deficiency or other large tax deficiency penalty applies.

A large tax deficiency penalty or a negligence penalty cannot be assessed when the fraud penalty has been assessed with respect to the same deficiency.

*Reference:* [G.S. § 105-236\(a\)\(5\)](#); [17 NCAC 06B .3204](#); [17 NCAC 06B .3404](#).

#### **5. Informational Return Penalties**

Pursuant to [G.S. § 105-236\(a\)\(10\)](#), the penalty for failure to file an informational return required by Article 4A, 5, 9, 36C, or 36D by the due date is \$50 per day, up to a maximum of \$1,000. In addition, a penalty of \$200 will be assessed if the informational return is not filed in the required format.

*Reference:* [G.S. § 105-236\(a\)\(10\)](#); [S.L. 2019-169](#).

#### **6. Failure to Report Federal Changes**

When a taxpayer fails to report federal changes within six months from the date the taxpayer is notified by the Internal Revenue Service of the correction or final determination, the taxpayer is subject to the failure to file penalty and forfeits the right to any refund as the result of the federal changes. The failure to file penalty begins at the expiration of the six-month period.

*Reference:* [G.S. § 105-159](#); [G.S. § 105-236](#).

#### **7. Fraud**

When an examination of an income tax return is based on a federal audit report and the fraud penalty has been assessed for federal purposes, the 50% fraud penalty will be assessed for State purposes. The fraud penalty may also be assessed when there is a deficiency or delinquency in payment of any tax because of fraud with intent to evade the tax. When the fraud penalty is assessed, no penalty for large tax deficiency, negligence or failure to pay shall be assessed with respect to the same deficiency; however, other penalties that apply, such as failure to file, will be assessed.

*Reference:* [G.S. § 105-236\(a\)\(6\)](#); [17 NCAC 06B .3206](#).

## 8. Collection Assistance Fee

Any tax, penalty, and interest not paid within 60 days after it becomes collectible under G.S. 105-241.22 is subject to a 20% collection assistance fee. The fee will not apply if the taxpayer enters into an installment payment agreement with the Department before the fee is imposed. The fee may be imposed on defaulted installment payment agreements.

*Reference:* [G.S. § 105-243.1](#); [S.L. 2020-58](#).

## 9. Interest

Interest accrues on tax not paid by the original due date even though a taxpayer may have an extension of time for filing the return. Interest accrues on overpayments beginning 45 days after the latest of (1) the date the final return was filed, (2) the date the final return was due to be filed, or (3) the date of the overpayment. The law requires the Secretary of Revenue to establish the interest rate on or before June 1 for the following six-month period beginning on July 1, and on or before December 1 for the following six-month period beginning on January 1. The rate set by the Secretary may not be less than 5% per year or greater than 16% per year. For more information, see [Interest Rate](#).

*Reference:* [G.S. § 105-241.21](#).

## 10. Underpayment of Estimated Income Tax

Interest on the underpayment of estimated income tax is computed on [Form D-422](#), Underpayment of Estimated Income Tax by Individuals. If interest on the underpayment is applicable, add the amount of the interest to the tax due and include the full payment with the return. For more information, see [Interest on Underpayment of Estimated Income Tax](#).

*Reference:* [G.S. § 163.15](#); [17 NCAC 06D .0201](#).

## 11. Waiver of Penalty or Interest

Penalties may be waived by the Secretary of Revenue pursuant to the Department's [Penalty Waiver Policy](#). A request for waiver or reduction of penalty generally must be in writing and must include an explanation for the request. To request a penalty waiver for any penalty other than an informational return penalty, taxpayers should complete and submit [Form NC-5500](#), Request to Waive Penalties. To request a penalty waiver for an informational return penalty, taxpayers should complete and submit [Form NC-5501](#), Request for Waiver of an Informational Return Penalty. When the request is based on the reason of good compliance, a request to waive a penalty can be made by telephone.

As a general rule, interest cannot be waived or reduced. However, interest may be waived or reduced if it has accrued on taxes imposed prior to or during a period for which the taxpayer has declared bankruptcy under Chapter 7 or Chapter 13 of Title 11 of the United States Code.

Limited interest relief was also granted by statute in response to the COVID-19 pandemic. Information about this interest relief is provided in [COVID-19 Provisions](#).

Review the Department's [Penalty Waiver Policy](#).

*Reference:* [G.S. § 105-237](#).

## **XVII. Estimated Income Tax**

### **1. Forms**

[Form NC-40](#) is the form for payment of estimated individual income tax. Form NC-40 is a four-part, non-personalized payment form. The four-part form includes the necessary vouchers and instructions for making payments. An individual can pay estimated tax online using the Department's [e-services for individuals](#) portal.

### **2. Requirements for Filing**

An individual must pay estimated income tax if the tax shown due on the income tax return for the taxable year, reduced by the North Carolina tax withheld and allowable tax credits, is \$1,000 or more regardless of the amount of income the individual has that is not subject to withholding. Married individuals can make joint payments of estimated income tax even if they are not living together; however, they may not make joint estimated tax payments if they are separated under a decree of divorce or of separate maintenance. Also, they may not make joint estimated tax payments if either of them is a nonresident alien or if either of them have different tax years.

Whether married individuals make joint estimated tax payments or separate payments will not affect their choice of filing a joint income tax return or separate returns. If they make joint payments and then file separate returns, they may determine how to divide the estimated tax payments between them.

A taxpayer filing a short period return because of a change in income year is required to make estimated income tax payments on the installment dates which fall within the short period and 15 days after the close of the short period. The payments should be calculated in the same manner as if the income year had not changed. Interest on the underpayment of estimated income tax for a short period will be computed for the period of underpayment based on the tax shown due on the short period return and computed in the same manner as it would have been computed had the taxpayer not changed his or her income year.

*Reference:* [G.S. § 105-163.15](#); [17 NCAC 06D .0102](#).

### **3. Applying Prior Year's Income Tax Refund to Current Year's Estimated Income Tax**

An individual may elect to have an income tax refund applied to estimated income tax for the following year. For example, an individual due a refund on the 2019 income tax return may have all or any portion of the refund applied to estimated tax for 2020. The individual may not however, file a 2018 tax return in 2020 and request the refund be applied to the 2020 estimated tax since the refund can only be applied to the tax year which follows the year for which the request for refund is made. The last allowable date for making a 2020 estimated tax payment is January 15, 2021; therefore, you must file your 2019 income tax return by January 15, 2021,

to elect to apply a portion of your refund to 2020 estimated tax. If an individual makes a valid election, that individual may not revoke the election after the return has been filed in order to have the amount refunded or applied in any other manner, such as an offset against any subsequent determined tax liability.

## **XVIII. Interest on the Underpayment of Estimated Income Tax**

### **1. General**

Interest may be due on the underpayment of estimated income tax. The interest is computed separately for each payment period; therefore, an individual may owe interest for an early period even if that individual later paid enough to make up the underpayment. An individual who did not pay enough tax by the due date of each of the payment periods may owe interest even if a refund is due when the return is filed.

*Reference:* [G.S. § 105-163.15](#); [17 NCAC 06D .0201](#).

### **2. Impact of COVID-19 Relief**

Under [Session Law 2020-3](#), the State provided limited relief from interest applied to estimated tax payments due between April 15, 2020, and July 15, 2020 (“COVID Period”) pursuant to G.S. § 105-163.15. Accordingly, the Secretary will waive the accrual of interest, during the COVID Period, owed on estimated tax payments due during the COVID Period.

*Reference:* [Session Law 2020-3](#).

### **3. Avoiding Interest on the Underpayment**

Interest on the underpayment of estimated income tax will not apply if the individual makes payments of estimated income tax on each installment date for 25% of the lesser of the following:

- a. 90% (66.67% for farmers and fishermen) of the tax (after tax credits) on the current year’s return,
- b. 100% of the tax on the preceding year’s return (provided it was a taxable year of 12 months and the individual filed a return for that year), or
- c. 90% (66.67% for farmers and fishermen) of the tax determined by annualizing the income received during the year up to the month in which the installment is due.

Also, no interest on an underpayment will be due if an individual had no tax liability for the preceding year or if the total tax shown on the current year return minus tax credits and the amount paid through withholding is less than \$1,000.

## 4. Underpayments

An underpayment is the excess of the required installment (or, if lower, the annualized income installment) for a payment period over the portion of the amount paid by the due date that is not applied to an underpayment for an earlier payment period.

Payments include income tax withheld, which are considered payments of estimated tax in equal installments on the required installment dates (usually four), unless the individual can prove otherwise. A payment of estimated tax is credited against unpaid installments in the order in which the installments are required to be paid.

*Reference:* [17 NCAC 06D .0207](#).

## 5. Overpayments

An overpayment for any period occurs when the withholding and estimated tax payments are more than the total of any underpayments for an earlier period plus the lesser of the required installment or the annualized income installment for the period. If there is an overpayment for a period, it should be carried to the next period and added to the withholding and estimated tax paid for that later period to determine any underpayment or overpayment for that later period.

*Reference:* [17 NCAC 06D .0208](#).

## 6. Determining an Underpayment

No interest will be due if the estimated tax payments were made on time and the payment for each period was at least as much as either the required installment or the annualized income installment for the period. To determine an underpayment, use [Form D-422](#), Underpayment of Estimated Tax by Individuals.

The required installment for any payment period is the lesser of 22.5% of the tax shown on the current year return or 25% of the tax shown on the prior-year return (if the prior-year return covered all 12 months of the year). However, if the annualized income installment for any period is less than the required installment for the same period and the annualized income installment is used in determining the underpayment, add the difference between the annualized income installment and the required installment to the required installment for the next period. If the annualized income installment for the next payment period is used, add the difference between the annualized income installment for that period and the required installment (as increased) for that period to the required installment for the following payment period.

There will be no underpayment for any payment period in which the estimated tax payments, reduced by any amounts applied to underpayments in earlier periods, were paid by the due date for the period and were at least as much as the annualized income installment for the period.

*Reference:* [17 NCAC 06D .0209](#).

## 7. Period of Underpayment

Underpayment interest is applied to the number of days that the installment was not paid. For tax year 2020, for example, determine the period of the underpayment by counting the number of days after the due date of the installment to and including the date of payment, or April 15, 2021, whichever is earlier. Fiscal year taxpayers use the 15th day of the 4th month following the close of the fiscal year instead of April 15, 2021.

Calendar year taxpayers' payments are due on April 15, June 15, and September 15, and January 15 of the following year. If the 15th of the month is on a weekend or holiday, the payment is due on the next business day.

Payments for fiscal year taxpayers are due on the 15th day of the 4<sup>th</sup> month, the 15th day of the 6th month, and the 15th day of the 9th month of the fiscal year, and the 15th day of the 1st month after the end of the fiscal year.

Periods and amounts of underpayment are determined by applying estimated tax payments to any underpayments of earlier installments in the order in which such installments were required to be paid.

If a payment of estimated tax is applied to an underpayment for an earlier period, but the payment is less than the underpayment, there will be more than one period of underpayment for the earlier period.

The first period of underpayment for any payment period will be from the day after the due date for the payment period to the date of the first applied payment. Later periods of underpayment for that payment period will be from the day after the due date for the payment period to the date of the next applied payment or April 15 of the following year, whichever is earlier.

To determine the interest for a payment period with more than one period of underpayment, compute interest separately for each of the periods of underpayment using the number of days in each period of underpayment, the correct underpayment balance, and the appropriate interest rates.

*Reference:* [17 NCAC 06D .0210](#).

## 8. Farmers and Fishermen

The following special rules for underpayment of estimated tax apply to farmers and fishermen:

- a. Interest for underpaying 2020 estimated tax will not apply if the return is filed and all tax is paid by March 1, 2021. For fiscal year taxpayers, interest will not apply if the return is filed and tax due is paid by the first day of the third month after the end of the tax year.



- b. Any interest owed for underpaying 2020 estimated tax will be determined from one payment due date, January 15, 2021.
- c. Underpayment interest for 2020 is computed on the difference between the amount of estimated tax paid by the due date and the lesser of 100% of the tax shown on the 2019 return or 66.67% of the 2020 tax.

In addition to the special rules, farmers and fishermen will not have to pay underpayment interest if the tax due (less withholding and tax credits) is less than \$1,000 or if there was no tax liability for the prior year.

## **9. Joint and Separate Returns**

### **a. Joint Estimated Tax Payments**

Spouses may make joint estimated tax payments in most circumstances. However, taxpayers that are legally separated under a decree of divorce or have different tax years cannot make joint estimated tax payments. In addition, if either spouse is a nonresident alien (unless that spouse elected to be treated as a resident alien for tax purposes), the spouses cannot make joint estimated tax payments.

### **b. Calculating Preceding Year's Tax for Joint Returns**

For the purposes of determining whether there has been an underpayment of tax for the current year, a taxpayer may need to determine the amount of the preceding year's tax. Taxpayers planning to file jointly in the current tax year that also filed jointly in the preceding year may simply use the tax amount on the preceding year's joint return.

Taxpayers that plan to file a joint return in the current tax year but filed separate returns in the preceding year must add the total tax on their separate returns in the preceding year to determine the preceding year's tax.

### **c. Calculating Preceding Year's Tax for Separate Returns**

For the purposes of determining whether there has been an underpayment of tax for the current year, a taxpayer may need to determine the amount of the preceding year's tax. A married taxpayer planning to file separately in the current tax year that also filed separately in the preceding year may simply use the tax amount on the preceding year's separate return.

A taxpayer planning to file a separate return in the current tax year that filed a joint return in the preceding year must determine his or her share of the tax on the preceding year's joint return. To determine the share of the tax on a joint return, the taxpayer must first find the tax each spouse would have paid in the preceding year had they filed separate returns (using the filing statuses they plan to use for the current year). The taxpayer must then multiply the tax on the preceding year's joint return by the following fraction:

Taxpayer's tax due if a separate return  
would have been filed in preceding year

Total tax due from both spouses if separate  
returns would have been filed in preceding year

# XIX. Critical Infrastructure Disaster Relief Work

## 1. General

[Session Law 2019-187](#) added new section G.S. 166A-19.70A to exclude nonresident businesses and nonresident employees who temporarily come to North Carolina at the request of a critical infrastructure company solely to perform disaster-related work during a disaster response period from certain tax and regulatory requirements.

A **nonresident business** is defined as an entity that has not been required to file an income or franchise tax return with North Carolina for three years prior to the disaster response period, other than those arising from the performance of disaster-related work during a tax year prior to the enactment of Session Law 2019-187. The entity must either be a nonresident entity as defined in G.S. 105-163.1 or a nonresident individual who owns an unincorporated business as a sole proprietor.

A **nonresident employee** is defined as a nonresident individual who is an employee of a nonresident business or an employee of a critical infrastructure company who is temporarily in this State to perform disaster-related work during a disaster response period.

A nonresident business or nonresident employee is exempt from the following tax and regulatory requirements:

- Corporate income tax, as provided under G.S. 105-130.1.
- Individual income tax, as provided under G.S. 105-153.2.
- Franchise tax, as provided under G.S. 105-114.
- Unemployment tax, as provided under G.S. 96-1(b)(12).
- Certificate of Authority from the Secretary of State to transact business in this State, as provided under G.S. 55-15-01(d) and G.S. 57D-1-24(d).

*Reference:* [G.S. § 166A-19.70A](#); [G.S. § 166A-19.3](#); [S.L. 2019-169](#).

## 2. Common Questions

- **When does a “disaster response period” begin?**

The disaster response period begins 10 days prior to the first day of a disaster declaration.

- **When does a “disaster response period” end?**

The disaster response period ends on the earlier of the following:

- Sixty days following the expiration of the disaster declaration, as provided under G.S. 166A-19.21(c).
- One hundred eighty days following the issuance of the disaster declaration.

- **What is a “disaster declaration?”**

A gubernatorial declaration that the impact or anticipated impact of an emergency constitutes a disaster of one of the types enumerated in G.S. 166A-19.21(b).

- **What is considered “disaster-related work?”**

Repairing, renovating, installing, building, or performing services on critical infrastructure that has been damaged, impaired, or destroyed as a result of a disaster or emergency in an area covered by the disaster declaration.

- **What is a “critical infrastructure company?”**

A registered public communications provider or a registered public utility. A registered public communications provider is a corporation doing business in North Carolina prior to the disaster declaration that provides the transmission to the public of one or more of the following: Broadband; Mobile telecommunications; Telecommunications; or Wireless Internet access.

A registered public utility is a corporation doing business in North Carolina prior to the disaster declaration that is subject to the control of one or more of the following entities: the North Carolina Utilities Commission; the North Carolina Rural Electrification Authority; the Federal Communications Commission; or the Federal Energy Regulatory Commission.

*Reference:* [G.S. § 166A-19.70A](#); [G.S. § 166A-19.3](#).

### **3. Applicability to Individuals**

#### **a. General**

A nonresident individual who solely derives income from North Carolina sources attributable to a business, trade, profession, or occupation carried on in North Carolina to perform disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file a North Carolina individual income tax return. This exclusion applies whether the nonresident individual is a nonresident business or a nonresident employee as defined by [G.S. § 166A-19.70A](#).

*Reference:* [G.S. § 166A-19.70A](#); [G.S. § 105-153.8\(a\)](#).

#### **b. Limitation**

The relief does not apply to any tax year that is part of the disaster response period if the nonresident individual continues to perform disaster-related work following the end of the disaster response period. The relief also does not apply to a tax year that is part of the

disaster response period if the nonresident individual is required to file an income tax return for that tax year with the Department of Revenue for reasons other than the performance of disaster-related work.

*Reference:* [G.S. § 166A-19.70A](#); [G.S. § 105-153.8\(a\)](#).

**c. Examples**

**Example 1.** Taxpayer is employed by a critical infrastructure company. Taxpayer is domiciled in Tennessee. Taxpayer arrives in North Carolina during the disaster response period at the request of a critical infrastructure company to perform disaster related work.

Taxpayer is not required to file or pay North Carolina individual income tax for the income earned in North Carolina attributable to the disaster-related work during the disaster response period.

**Example 2.** Same facts as Example 1, except Taxpayer also owns a rental house in North Carolina for which he receives rental income.

Taxpayer is required to file a North Carolina individual income tax return due to the rental income earned in North Carolina. As a result, Taxpayer will be required to file and pay tax as a nonresident on all income attributable to North Carolina, including wage income earned for disaster-related work.

**Example 3.** Taxpayer is a sole proprietor domiciled in Georgia. Taxpayer has no filing requirement with North Carolina prior to the disaster response period. During the disaster response period, Taxpayer independently comes to North Carolina to perform repair work following the disaster.

Taxpayer did not come to North Carolina at the request of a critical infrastructure company. Therefore, Taxpayer must file and pay North Carolina tax on the income earned in North Carolina.

**Example 4.** Taxpayer is employed by a nonresident business. Taxpayer is domiciled in South Carolina. A critical infrastructure company requests Taxpayer's employer to perform disaster-related work during a disaster response period in North Carolina. Taxpayer performs disaster-related work in North Carolina in the course of his employment with the nonresident business during a disaster response period.

Taxpayer is not required to file or pay North Carolina individual income tax for the income earned in North Carolina attributable to the disaster-related work during the disaster response period.

**Example 5.** Individual 1 is a resident of South Carolina. A critical infrastructure company employs Individual 1 to perform disaster-related work during a disaster response period in

North Carolina. Individual 1 is married to Individual 2. Individual 2, also a resident of South Carolina, is employed in North Carolina.

If Individual 1 and Individual 2 elect to file a joint North Carolina individual income return, Individual 1 will be required to pay North Carolina tax on income earned in North Carolina for performing disaster-related work. If Individual 2 does not file a joint North Carolina individual income tax return with Individual 1, but instead files a married filing separate North Carolina individual income tax return, Individual 1's income earned in North Carolina for performing disaster-related work will not be included on Individual 2's North Carolina tax return. Moreover, Individual 1 will not be required to file a North Carolina individual income tax return.

#### **4. Applicability to Pass-Through Entities**

##### **a. General**

[Session Law 2019-187](#) added provisions to G.S. 105-131.7 providing that an S Corporation that is not doing business in North Carolina because it is a nonresident business performing disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file a return with the Department.

Similarly, G.S. 105-154(c) was amended to provide that a partnership that is not doing business in North Carolina because it is a nonresident business performing disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file an information return with the Department.

*Reference:* [Session Law 2019-187](#); [G.S 105-131.7](#); [G.S. 105-154](#).

##### **b. Limitation**

The relief does not apply to any tax year that is part of the disaster response period if the nonresident business continues to perform disaster-related work following the end of the disaster response period. The relief does not apply to a tax year that is part of the disaster response period if the nonresident business is required to file an income tax return for that tax year with the Department of Revenue for reasons other than the performance of disaster-related work.

*Reference:* [Session Law 2019-187](#).

##### **c. Shareholder and Partner Information Requirements**

The provisions of Session Law 2019-187 only relieve a nonresident shareholder or partner of his or her North Carolina filing responsibility if the nonresident meets all of the provisions of the law. If the nonresident shareholder or partner is subject to North Carolina taxation, that person will need information from the S corporation or the partnership in order to properly file his or her North Carolina tax return.

However, the S Corporation or partnership may not have sufficient information to determine whether a nonresident shareholder or partner is subject to North Carolina tax. Consequently, pass-through entities exempted from a filing requirement under Session Law 2019-187 must still provide to each shareholder or partner any information necessary for that person to file a North Carolina income tax return.

*Reference:* [Session Law 2019-187](#); [G.S 105-131.7](#); [G.S. 105-154](#).

#### **d. Examples**

**Example 1.** In 2019, a nonresident partnership (Partnership ABC) performs disaster-related services in North Carolina during a disaster response period at the request of a critical infrastructure company. Partnership ABC has one resident partner and one nonresident partner.

For tax year 2019, Partnership ABC is not doing business in North Carolina and is not required to file an information return (Form D-403) with the Department. Partnership ABC must issue income information (Schedule D-403 K-1) to each partner for 2019.

**Example 2.** In 2019, Partnership XYZ makes and sells widgets at its retail location in North Carolina. Partnership XYZ also performs disaster-related services in North Carolina during a disaster response period at the request of a critical infrastructure company. Partnership XYZ has two nonresident partners.

For tax year 2019, Partnership XYZ is doing business in North Carolina and is required to file an information return (Form D-403) with the Department. Partnership XYZ must also issue income information (Schedule D-403 K-1) to each partner for 2019.

**Example 3.** Partner A is a nonresident partner in Partnership ABC from Example 1 with no other income derived from North Carolina sources in 2019.

Partner A will receive income information (Schedule D-403 K-1) from Partnership ABC for 2019. Partner A will not be required to pay North Carolina individual income tax or file a North Carolina individual income tax return for 2019.

**Example 4.** Partner B is a partner in both Partnership ABC and Partnership XYZ from Examples 1 and 2.

Partner B will receive income information (Schedule D-403 K-1) from Partnership ABC and Partnership XYZ for 2019. Because Partner B derives income from North Carolina sources attributable to a business carried on in North Carolina that is not related to disaster-related work, Partner B is subject to North Carolina tax on income earned from both Partnership ABC and Partnership XYZ. Partner B is required to file an individual income tax return (Form D-400) with the Department.

## **5. Applicability to Withholding**

### **a. Wages**

Amounts paid to a nonresident employee for a business, trade, profession, or occupation carried on in North Carolina to perform disaster-related work during a disaster response period at the request of a critical infrastructure company are not considered wages. As such, these amounts are excluded from the withholding requirements of G.S. 105-163.2 and employers are not required to withhold from the amounts the State income taxes payable by the employee.

*Reference:* [G.S. § 105-163.1](#); [G.S. § 105-163.2](#).

### **b. Non-Wage Compensation**

The withholding requirements of G.S. 105-163.3 for non-wage compensation do not apply to compensation paid by a nonresident business or a critical infrastructure company to an ITIN contractor who is a nonresident individual for a business, trade, profession, or occupation carried on in this State to perform disaster-related work during a disaster response period at the request of a critical infrastructure company.

*Reference:* [G.S. § 105-163.3](#).

### **c. Informational Return Requirements under G.S. § 105-163.7**

A nonresident business employer performing disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file an information return with the Secretary under G.S. 105-163.7. However, the employer must furnish to an employee, upon request, any information necessary for that person to properly file a State income tax return.

*Reference:* [G.S. § 105-163.7](#).

## **6. Required Notifications**

### **a. Critical Infrastructure Company Notification**

A critical infrastructure company must provide notification to the Department within 90 days of the expiration of the disaster response period on Form NC-CICN: Critical Infrastructure Company Notification. The critical infrastructure company notification must include the following information for each nonresident businesses who performed disaster-related work in this State during a disaster response period at the request of the critical infrastructure company:

- (1) The legal name of the nonresident business.
- (2) The taxpayer identification number of the nonresident business.



- (3) The principal address of the nonresident business.
- (4) The date of entry into North Carolina for the nonresident business.
- (5) The date of exit from North Carolina for the nonresident business.

The critical infrastructure notification must include the following information for each nonresident employee of the critical infrastructure company who performed disaster-related work in this State for the critical infrastructure company during a disaster response period:

- (1) The legal name of the nonresident employee.
- (2) The social security number of the nonresident employee.
- (3) The principal address of the nonresident employee.
- (4) The date of entry into North Carolina for the nonresident employee.
- (5) The date of exit from North Carolina for the nonresident employee.
- (6) The amount of compensation paid to the nonresident employee for performing disaster-related work in North Carolina for each calendar year the nonresident employee performed disaster-related work.

*Reference:* [Session Law 2019-187](#).

#### **b. Nonresident Business Notification**

A nonresident business must provide notification to the Department within 90 days of the date the nonresident business concludes its disaster-related work in the State on Form NC-NBN, Nonresident Business Notification. The nonresident business notification must include the following information for each nonresident employee of the nonresident business who performed disaster-related work in this State for the nonresident business during a disaster response period:

- (1) The legal name of the nonresident employee.
- (2) The social security number of the nonresident employee.
- (3) The principal address of the nonresident employee.
- (4) The date of entry into North Carolina for the nonresident employee.
- (5) The date of exit from North Carolina for the nonresident employee.
- (6) The amount of compensation paid to the nonresident employee for performing disaster-related work in North Carolina for each calendar year the nonresident employee performed disaster-related work.

A nonresident business that fails to submit this timely notification to the Department forfeits the relief provided by [Session Law 2019-187](#). Consequently, it is not excluded from and must abide by North Carolina's tax and regulatory requirements. However, the disqualification of a nonresident business for failure to timely provide notification does not automatically disqualify the nonresident employees of the nonresident business. Those employees are still eligible for the relief specified in [Session Law 2019-187](#) if they meet the requirements of the statute.

*Reference:* [Session Law 2019-187](#).

## XX. Bonus Asset Basis

### 1. General

Taxpayers are allowed 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.

*Reference:* [G.S. § 105-153.6\(e\)](#).

### 2. Definitions

**Transferor.** An individual, partnership, corporation, S corporation, limited liability company, or an estate or trust that does not fully distribute income to its beneficiaries.

**Owner in a transferor.** One or more of the following of a transferor:

- A partner, shareholder, or member.
- A beneficiary subject to North Carolina income taxation.

**Remaining life of the asset.** The remaining years in the asset's federal recovery period, as determined under section 168(c) of the Code.

### 3. Bonus Asset Basis Adjustments

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

- a. There is an actual or deemed transfer of an asset;
- b. The tax basis of the transferred asset carries over from the transferor to the transferee for federal income tax purposes; and
- c. Each transferor or owner in a transferor that added bonus depreciation to its federal taxable income or adjusted gross income, as appropriate, certifies in writing that they will not take any remaining future State bonus depreciation deductions associated with the transferred asset.

When the above requirements are met, the transferee is eligible to deduct the remaining bonus depreciation deductions associated with the transferred asset. An adjustment to federal adjusted gross income is required for each year the asset with the bonus asset basis is depreciated. In addition, upon sale or other 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.

## 4. Examples

A taxpayer is required to make an addition on the North Carolina return equal to a percentage of the amount of the bonus depreciation deducted on the federal return. The amount of the addition is then deducted ratably over a future five-year period. For example, a taxpayer makes an addition on the 2020 North Carolina return for 85% of the bonus depreciation deducted on the 2020 federal return. The taxpayer may then deduct 20% of the amount of the addition on each of the taxpayer's 2021 through 2025 North Carolina returns.

Pursuant to [G.S. § 105-153.6\(d\)](#), State adjustments for bonus depreciation do not result in a difference in basis for State and federal purposes, with the exception of when a bonus asset basis is created as described in this section.

**Example 1.** Taxpayer A purchased property on January 1, 2015, for \$100,000. The property qualified as 3-year property for federal depreciation purposes. The property also qualified for 100% bonus depreciation. On January 1, 2018, the property was transferred to Taxpayer B in an exchange resulting in Taxpayer A's tax basis in the property transferring to Taxpayer B. Taxpayer A and all owners in Taxpayer A certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred.

Taxpayer A's depreciation, basis, and State additions and deductions for 2015 through 2017 are as shown below.

<b>Taxpayer A (Transferor)</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Federal Bonus Depreciation	\$100,000	\$ 0	\$ 0
Federal Straight Line Depreciation	0	0	0
Federal Basis (after depreciation)	0	0	0
State Bonus Depreciation Addition	85,000	0	0
State Bonus Depreciation Deduction	0	17,000	17,000
State Basis	0	0	0

Taxpayer A is not entitled to a State bonus depreciation deduction in years after 2017.

Taxpayer B's federal tax basis in the property at the time of transfer is \$0 and the State bonus asset tax basis is \$51,000 calculated as follows:

Taxpayer A's Original Basis -	\$100,000
Less: Taxpayer A's Federal Depreciation -	(100,000)
Plus: State Bonus Depreciation Addition -	85,000
<u>Less: State Bonus Depreciation Deductions -</u>	<u>(34,000)</u>
State Bonus Asset Basis as of January 1, 2018	<b>\$ 51,000</b>

Taxpayer B's depreciation, basis, and State Bonus Asset Basis deductions for 2018 are as shown below.

<b>Taxpayer B (Transferee)</b>	<b>2018</b>
Federal Bonus Depreciation	\$ 0
Federal Straight Line Depreciation	0
Federal Basis (after depreciation)	0
State Bonus Asset Basis	51,000
State Bonus Asset Basis Deduction	51,000
State Basis (after deduction)	0

Because there is no remaining life of the property pursuant to section 168(c), Taxpayer B is entitled to a deduction in 2018, the year of transfer, for the cumulative remaining bonus depreciation deductions allowable to Taxpayer A at the time of transfer. Therefore, Taxpayer B is not entitled to a State bonus asset basis deduction in years after 2018.

**Example 2.** Taxpayer C purchased property on January 1, 2014, for \$100,000. The property qualified as 5-year property for federal depreciation purposes. The property also qualified for 100% bonus depreciation. On January 1, 2016, the property was transferred to Taxpayer D in an exchange resulting in Taxpayer C's tax basis in the property transferring to Taxpayer D. Taxpayer C and all owners in Taxpayer C certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred.

Taxpayer C's depreciation, basis, and State additions and deductions for 2014 and 2015 are as shown below.

<b>Taxpayer C (Transferor)</b>	<b>2014</b>	<b>2015</b>
Federal Bonus Depreciation	\$ 100,000	\$ 0
Federal Straight Line Depreciation	0	0
Federal Basis (after depreciation)	0	0
State Bonus Depreciation Addition	85,000	0
State Bonus Depreciation Deduction	0	17,000
State Basis	0	0

Taxpayer C is not entitled to a State bonus depreciation deduction in years after 2015.

Taxpayer D's federal tax basis in the property at the time of transfer is \$0 and the State bonus asset tax basis is \$68,000 calculated as follows:

Taxpayer C's Original Basis -	\$100,000
Less: Taxpayer C's Federal Depreciation -	(100,000)
Plus: State Bonus Depreciation Addition -	85,000
Less: State Bonus Depreciation Deductions -	(17,000)
State Bonus Asset Basis as of January 1, 2016	<b>\$ 68,000</b>

<b>Taxpayer D (Transferee)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Federal Bonus Depreciation	\$ 0	\$ 0	\$ 0
Federal Straight Line Depreciation	0	0	0
Federal Basis (after depreciation)	0	0	0
State Bonus Asset Basis	68,000	45,333	22,666
State Bonus Asset Basis Deduction	22,667	22,667	22,666
State Basis (after deductions)	45,333	22,667	0

Taxpayer D's bonus asset basis deduction beginning in tax year 2016 is calculated as follows:

Remaining Bonus Depreciation of Transferor -	\$68,000
Divided by the Remaining Life of the Asset -	÷ 3
Bonus Asset Basis Deduction	<u>\$22,667</u>

Taxpayer D is not entitled to a State Bonus Asset Basis deduction in years after 2018.

**Example 3.** Taxpayer E purchased property on January 1, 2010, for \$100,000. The property qualified as 5-year property for federal depreciation purposes. The property also qualified for 50% bonus depreciation. On January 1, 2013, the property was transferred to Taxpayer F in an exchange resulting in Taxpayer E's tax basis in the property transferring to Taxpayer F. Taxpayer E and all owners in Taxpayer E certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred.

Taxpayer E's depreciation, basis, and State additions and deductions for 2010 through 2012 are as shown below.

<b>Taxpayer E (Transferor)</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Federal Bonus Depreciation	\$ 50,000	\$ 0	\$ 0
Federal Straight Line Depreciation	10,000	10,000	10,000
Federal Basis (after depreciation)	40,000	30,000	20,000
State Bonus Depreciation Addition	42,500	0	0
State Bonus Depreciation Deduction	0	8,500	8,500
State Basis	40,000	30,000	20,000

Taxpayer E is not entitled to a State bonus depreciation deduction in years after 2012.

Taxpayer F's federal tax basis in the property at the time of transfer is \$20,000 and the State bonus asset tax basis is \$45,500 calculated as follows:

Taxpayer F's Original Basis -	\$100,000
Less: Taxpayer F's Federal Depreciation -	(80,000)
Plus: State Bonus Depreciation Addition -	42,500
Less: State Bonus Depreciation Deductions -	<u>(17,000)</u>
State Bonus Asset Basis as of January 1, 2013	<b>\$45,500</b>

<b>Taxpayer F (Transferee)</b>	<b>2013</b>	<b>2014</b>
Federal Bonus Depreciation	\$ 0	\$ 0
Federal Straight Line Depreciation	10,000	10,000
Federal Basis (after depreciation)	10,000	0
State Bonus Asset Basis	45,500	22,750
State Bonus Asset Basis Deduction	12,750	12,750
State Basis (after federal and State deductions)	22,750	0

Taxpayer F's bonus asset basis deduction beginning in tax year 2013 is calculated as follows:

Remaining Bonus Depreciation of Transferor -	\$25,500
Divided by the Remaining Life of the Asset -	÷ 2
Bonus Asset Basis Deduction	\$12,750

Taxpayer F is not entitled to a State Bonus Asset Basis deduction in years after 2014.

**Example 4.** Taxpayer G purchased property on January 1, 2010, for \$100,000. The property qualified as 10-year property for federal depreciation purposes. The property also qualified for 50% bonus depreciation. On January 1, 2013, the property was transferred to Taxpayer H in an exchange resulting in Taxpayer G's tax basis in the property transferring to Taxpayer H. Taxpayer G and all owners in Taxpayer G certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred. On January 1, 2015, Taxpayer H sells the property in a taxable exchange for \$200,000.

Taxpayer G's depreciation, basis, and State additions and deductions for 2010 through 2012 are as shown below.

<b>Taxpayer G (Transferor)</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Federal Bonus Depreciation	\$ 50,000	\$ 0	\$ 0
Federal Straight Line Depreciation	5,000	5,000	5,000
Federal Basis (after depreciation)	45,000	40,000	35,000
State Bonus Depreciation Addition	42,500	0	0
State Bonus Depreciation Deduction	0	8,500	8,500
State Basis	45,000	40,000	35,000

Taxpayer G is not entitled to a State bonus depreciation deduction in years after 2012.

Taxpayer H's federal tax basis in the property at the time of transfer is \$35,000 and the State bonus asset tax basis is \$60,500 calculated as follows:

Taxpayer G's Original Basis -	\$100,000
Less: Taxpayer G's Federal Depreciation -	(65,000)
Plus: State Bonus Depreciation Addition -	42,500
Less: State Bonus Depreciation Deductions -	(17,000)

State Bonus Asset Basis as of January 1, 2013

**\$60,500**

<b>Taxpayer H (Transferee)</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Federal Bonus Depreciation	\$ 0	\$ 0	\$ 0
Federal Straight Line Depreciation	5,000	5,000	0
Federal Gain (Loss)	N/A	N/A	175,000
Federal Basis (after depreciation)	30,000	25,000	N/A
State Bonus Asset Basis	60,500	51,857	43,214
State Bonus Asset Basis Deduction	3,643	3,643	18,214
State Basis (after federal and State deductions)	51,857	43,214	N/A

2013 and 2014 Bonus Asset Basis Deduction Calculation

Taxpayer H's bonus asset basis deduction beginning in tax year 2013 is calculated as follows:

Remaining Bonus Depreciation of Transferor -	\$25,500
<u>Divided by the Remaining Life of the Asset -</u>	<u>÷ 7</u>
Bonus Asset Basis Deduction	\$3,643 (rounded)

2015 State Deduction Calculation

At the time the property was sold, Taxpayer H's State tax basis was \$18,214 more than the federal tax basis; therefore, Taxpayer H is entitled to a deduction of \$18,214 on the State return for the difference in the gain for federal and State purposes. The gains were computed as shown below:

	<b>Federal</b>	<b>State</b>
Proceeds from the sale	\$ 200,000	\$ 200,000
Tax Basis at the time of sale	25,000	43,214
Gain (Loss)	175,000	156,786

Taxpayer H is not entitled to a State bonus asset deduction in years after 2015.

# XXI. Net Operating Losses

## 1. General

Federal adjusted gross income (“AGI”) is the starting point in determining North Carolina taxable income. The elements involved in computing a net operating loss (“NOL”) are included in the calculation of federal adjusted gross income. In general, North Carolina law does not require or permit a separate calculation of an NOL for State purposes and an NOL must be carried to the same tax year(s) for federal and State individual income tax purposes. However, the [Coronavirus Aid, Relief, and Economic Security Act](#) (“CARES Act”), enacted in March of 2020, made a number of changes to the NOL provisions enacted by the Tax Cuts and Jobs Act of 2017 (“TCJA”) for tax years 2018, 2019, and 2020. [Session Law 2020-58](#) decoupled from the NOL provisions of the CARES Act.

## 2. Determining Net Operating Losses

Because federal adjusted gross income is the starting point for determining North Carolina taxable income, the amount of NOL determined for federal income tax purposes is generally the NOL for State income tax purposes. The law does not require or permit a separate calculation of an NOL for State purposes. Where North Carolina law decouples from federal NOL provisions, it does so through separate additions to and deductions from federal AGI. For more information on determining federal NOLs, see the IRS website and IRS Publication 536.

**Note:** A nonresident or part-year resident must make an additional calculation to determine the portion of the total NOL that is from North Carolina sources. See [Effect of Residency Status on Net Operating Losses](#) for additional information.

## 3. State Decoupling Provisions for NOLs Arising in 2018, 2019, and 2020

### a. Background

Historically, NOLs could be carried back for up to two years and forward for up to twenty years. After the enactment of the TCJA, NOLs arising in tax years ending after 2017 could only be carried forward for most taxpayers. There was a limited exception that applied to certain farming losses. For NOLs arising in taxable years beginning after December 31, 2017, the TCJA generally limited the amount of the NOL deduction to 80% of taxable income.

The CARES Act modified certain NOL provisions. In particular, the CARES Act allowed a five-year carryback for NOLs incurred in tax years 2018, 2019, and 2020. Furthermore, the CARES Act suspended the NOL carryforward deduction limitation until tax year 2021 for NOLs incurred during tax years 2018, 2019, and 2020. [Session Law 2020-58](#) decoupled North Carolina law from these provisions of the CARES Act.



**b. Net Operating Loss (“NOL”) Carryback Incurred in Tax Years 2018, 2019, and 2020**

The TCJA generally eliminated net operating loss (NOL) carrybacks and permitted NOLs to be carried forward indefinitely. The CARES Act amended those rules temporarily by permitting NOLs incurred in 2018, 2019, and 2020 to be carried back for five years from the tax year of the loss, unless the individual elects to waive the carryback period. North Carolina chose not to adopt this provision of the CARES Act. Instead, for North Carolina tax purposes, an NOL incurred in 2018, 2019, and 2020 carried back for federal tax purposes must be added to AGI for tax years 2013 through 2019.

[G.S. § 105-153.5\(c2\)\(8\)](#) requires an individual, for tax years 2013, 2014, 2015, 2016, or 2017, to add to AGI the amount of any 2018 NOL deducted and absorbed on a federal tax return under section 172 of the Code.

[G.S. § 105-153.5\(c2\)\(9\)](#) requires an individual, for taxable years 2014, 2015, 2016, 2017, or 2018, to add to AGI the amount of any 2019 NOL deducted and absorbed on a federal tax return under section 172 of the Code.

[G.S. § 105-153.5\(c2\)\(10\)](#) requires an individual, for taxable years 2015, 2016, 2017, 2018, or 2019, to add to AGI the amount of any 2020 NOL deducted and absorbed on a federal tax return under section 172 of the Code.

[G.S. § 105-153.5\(c2\)\(14\)](#) provides a deduction from AGI for the amount of NOL carryback deduction required to be added to AGI under G.S. 105-153.5(c2)(8), (9), or (10). An individual may deduct 20% of the amount added to AGI in tax years 2013 through 2019 in each of the first five taxable years beginning on or after January 1, 2021.

**Note:** The addition under G.S. 105-153.5(c2)(8), (9), or (10) is not required for farming losses carried back by the individual under the provisions of section 172(b)(1)(B) of the Code.

[G.S. § 105-153.5\(c2\)\(11\)](#) requires an individual, for taxable years 2013, 2014, 2015, 2016, 2017, 2018, or 2019, to add to AGI the amount of any 2018, 2019, or 2020 net operating loss carried back and deducted on a federal return pursuant to [G.S. § 105-153.5\(c2\)\(8\)-\(10\)](#) but not absorbed in that year and carried forward to a subsequent year. “Absorbed” means the amount of NOL carried to a year less the amount of NOL carried forward from that year. This addition is not required to the extent the unabsorbed NOL must already be added back pursuant to [G.S. § 105-153.5\(c\)\(6\)](#).

**Note:** For an NOL carried over to taxable years beginning prior to January 1, 2014, or to taxable years beginning on or after January 1, 2016, and not completely absorbed for federal purposes, an addition to federal taxable or federal adjusted gross income is required by [G.S. § 105-153.5\(c\)\(6\)](#) for the amount of NOL carried forward from that year.

**Example 1:** Taxpayer has an NOL of \$100,000 for tax year 2020. Under the provisions of the CARES Act, Taxpayer carries her 2020 NOL to 2015. The \$100,000 NOL is fully absorbed in 2015.

For North Carolina purposes, Taxpayer will amend her 2015 North Carolina individual income tax return to reflect the \$100,000 reduction in AGI due to the NOL carryback. Taxpayer will also report a \$100,000 addition on the 2015 North Carolina return due to North Carolina's decoupling from the five-year carryback provision of the CARES Act.

Taxpayer will be able to deduct \$20,000 (20% of \$100,000) per year for five years as a North Carolina deduction from AGI beginning in 2021.

**Example 2:** Taxpayer had an NOL of \$50,000 for tax year 2018 which Taxpayer carried forward under the provisions of the TCJA to tax year 2019, where it was fully absorbed. In 2020, Taxpayer carries her 2018 NOL to 2013 under the provisions of the CARES Act. The 2018 NOL is fully absorbed in 2013. Taxpayer also amends her 2019 return to remove the previously claimed \$50,000 NOL carryforward from 2018.

For North Carolina purposes, Taxpayer will amend her 2013 North Carolina individual income tax return to reflect the \$50,000 reduction in AGI due to the NOL carryback. Taxpayer will also have a \$50,000 addition on the 2013 North Carolina return due to North Carolina's decoupling from the five-year carryback provision of the CARES Act.

Taxpayer will be able to deduct \$10,000 (20% of \$50,000) per year for five years as a North Carolina deduction from AGI beginning in 2021.

Taxpayer will also amend her 2019 North Carolina return to reflect the increase in federal AGI shown on her amended federal return for that year.

**Example 3:** Taxpayer has an NOL of \$100,000 for tax year 2020. Under the provisions of the CARES Act, Taxpayer carries her 2020 NOL to 2015. \$20,000 of the NOL is absorbed in 2015 and \$80,000 is carried forward to 2016, where \$30,000 is absorbed. The remaining \$50,000 is carried to 2017, where it is fully absorbed.

Taxpayer will amend her 2015 North Carolina individual income tax return to reflect the \$100,000 reduction in AGI due to the NOL carryback. Taxpayer will make an addition to AGI of \$20,000 for the portion of the 2020 NOL carried back and absorbed for federal purposes. Because no addition is required under G.S. § 105-153.5(c)(6) for the unabsorbed NOL in 2015, the Taxpayer must make a 2015 North Carolina addition under G.S. § 105-153.5(c)(11) for the \$80,000 of unabsorbed NOL.

Taxpayer will amend her 2016 North Carolina individual income tax return to reflect the \$80,000 reduction in AGI due to the 2020 NOL. Taxpayer will make an addition to AGI of \$30,000 on her 2016 return for the \$30,000 of 2020 NOL absorbed in 2016. Taxpayer will also make an addition of \$50,000 as required under G.S. 105-153.5(c)(6) for the

unabsorbed NOL in 2016. Because of the G.S. § 105-153.5(c)(6) addition, Taxpayer is not required to make an addition under G.S. § 105-153.5(c2)(11).

Taxpayer will amend her 2017 North Carolina individual income tax return to reflect the \$50,000 reduction in AGI due to the 2020 NOL. Taxpayer will make an addition to AGI of \$50,000 on her 2017 return for the \$50,000 of 2020 NOL absorbed in 2017.

Taxpayer will be able to deduct \$20,000 (20% of \$20,000 + \$30,000 + \$50,000) per year for five years as a North Carolina deduction from AGI beginning in 2021.

**c. NOL Limit of Eighty Percent of Taxable Income for Tax Years 2018, 2019, and 2020**

The TCJA amended section 172 of the Code to impose a new 80% NOL limitation starting with NOLs generated after January 1, 2018. Under the provisions of the TCJA, a taxpayer's NOL carryforward deduction was limited to 80% of federal taxable income without regard to the NOL deduction. The CARES Act temporarily removed the 80% NOL limitation for tax years 2018, 2019, and 2020, reinstating the limitation for tax years beginning after December 31, 2020. Thus for federal income tax purposes, for tax years 2019 and 2020, an individual can utilize 100% of an NOL carry forward from years 2018 or 2019 to offset federal taxable income.

North Carolina chose not to adopt this provision of the Code. Instead, for North Carolina tax purposes, an NOL carryforward deduction taken in tax years 2019 or 2020, resulting from an NOL incurred in tax years 2018 or 2019, must be added to AGI to the extent that the federal deduction exceeds the amount allowed under the provisions of section 172 of the Code as enacted as of January 1, 2019 (i.e., pre-CARES Act).

[G.S. § 105-153.5\(c2\)\(13\)](#) requires an individual to add to AGI the amount by which the individual's NOL carryforward deduction for an NOL arising in 2018, 2019, or 2020, exceeds the amount allowed under the provisions of section 172(a)(2)(B) of the Code, as enacted as of January 1, 2019.

[G.S. § 105-153.5\(c2\)\(16\)](#) provides a deduction from AGI for the amount of the 80% NOL carryforward deduction limitation required to be added to AGI under [G.S. § 105-153.5\(c2\)\(13\)](#). An individual may deduct 20% of the amount added to an individual's AGI in tax years 2019 and 2020, in each of the first five taxable years beginning on or after January 1, 2021.

See [Net Operating Loss Carryovers and Absorption](#) for more information.

**d. NOL Resulting from Excess Business Loss under IRC § 461(l)**

To the extent a taxpayer's excess business loss is added under subdivision (8), (9), or (10) of [G.S. § 105-153.5\(c2\)](#) as an NOL, the taxpayer is not required to make an addition under [G.S. § 105-153.5\(c2\)\(12\)](#) for the excess business loss. See [Excess Business Losses](#) for additional information.

## 4. Net Operating Loss Carryovers and Absorption

### a. General

Because federal adjusted gross income is the starting point for determining North Carolina taxable income, generally the amount of NOL carried over and absorbed for federal purposes is the same amount carried over and deducted for State purposes. “Absorbed” means the amount of NOL carried to a year less the amount of NOL carried forward from that year. For an NOL carried over to taxable years beginning on or after January 1, 2016, and not completely absorbed for federal purposes, an addition is required under [G.S. § 105-153.5\(c\)\(6\)](#) for the amount of NOL carryover that is not absorbed and will be carried forward to subsequent years.

If, in the year to which the loss is carried, adjustments are required to the State return which result in the taxpayer not receiving full benefit of the carryover, no additional carryover of the portion of the loss not resulting in a benefit is permitted.

### b. 80% Limitation for NOLs arising during Tax Years 2018-2020

If a federal NOL carryforward is deducted in 2020 from an NOL arising during 2018 or 2019, that carryforward for North Carolina purposes cannot exceed the amount allowed under the provisions of Code § 172 as enacted as of January 1, 2019 (i.e., the TCJA provisions). To the extent the federal NOL deduction exceeds the TCJA limitation, [G.S. § 105-153.5\(c\)\(13\)](#) requires the taxpayer to add back the amount of the deduction on the North Carolina return. The addition also only applies to the extent that the excess federal NOL deduction is absorbed on the federal return.

Under [G.S. § 105-153.5\(c\)\(16\)](#), the amount added back to a taxpayer’s AGI may be deducted in five equal installments beginning in tax year 2021. An installment, or portion of an installment, that is not utilized in a tax year cannot be carried forward to a subsequent tax year.

**Note:** To the extent the federal NOL deduction also results in an unabsorbed portion of the NOL being carried forward to a subsequent year, the taxpayer must make an addition under [G.S. § 105-153.5\(c\)\(6\)](#) for the amount of unabsorbed NOL carryover.

### c. Examples

**Example 1:** Taxpayer incurs an NOL of \$100,000 in 2019. Taxpayer carries the NOL to the 2020 federal return. Taxpayer has \$100,000 of federal taxable income in 2020 without regard to the NOL deduction. Under the CARES Act provisions, Taxpayer deducts the full amount of the NOL in 2020 and it is fully absorbed.

An addition is required on the Taxpayer’s 2020 North Carolina income tax return for the amount by which the Taxpayer’s federal NOL deduction exceeded the amount allowed under provisions of Code § 172 as enacted as of January 1, 2019. In this case, Taxpayer

will make an addition of \$20,000 in tax year 2020 (\$100,000 absorbed federal NOL carryforward deduction less \$80,000 (80% of federal taxable income without regard to the NOL deduction)). Beginning in 2021, Taxpayer will be able to deduct \$4,000 per year (20% of the addition) for five years.

**Example 2:** Taxpayer incurs an NOL of \$100,000 in 2019. Taxpayer carries the NOL to the 2020 federal return. Taxpayer has \$60,000 of federal taxable income in 2020. Under the CARES Act provisions, Taxpayer deducts the full amount of the NOL in 2020 and has a \$40,000 unabsorbed NOL carryforward.

An addition is required on the Taxpayer's 2020 North Carolina income tax return for the amount by which the Taxpayer's federal NOL deduction exceeded the amount allowed under provisions of Code § 172 as enacted as of January 1, 2019. In this case, Taxpayer will make an addition of \$12,000 (\$60,000 absorbed federal NOL carryforward deduction less \$48,000 (80% of federal taxable income without regard to the NOL deduction)) in tax year 2020. Beginning in 2021, Taxpayer will be able to deduct \$2,400 per year (20% of the addition) for five years. Taxpayer must also make an addition in 2020 for the amount of unabsorbed NOL carryover, \$40,000.

*Reference:* [G.S. § 105-153.5\(c\)\(6\)](#); [Session Law 2020-58](#).

## 5. Effect of Residency Status on Net Operating Losses

### a. General

The amount of NOL carried over and absorbed for federal tax purposes is also the amount carried over and deducted for State tax purposes. Accordingly, the amount of NOL is the same for State and federal purposes. However, a nonresident or part-year resident must make an additional calculation to determine the portion of the total NOL that is from North Carolina sources.

### b. Residents

If a taxpayer is a resident in the year to which an NOL is carried, the taxpayer receives the full benefit of the deduction. This occurs regardless of whether the NOL resulted from North Carolina source activities or whether the taxpayer was a nonresident or a part-year resident in the year the NOL was incurred.

**Example 1:** Taxpayer is a nonresident during 2019 when Taxpayer incurs a net operating loss of \$100,000. None of the loss is attributable to North Carolina sources. Taxpayer carries the NOL to the 2020 federal return. Taxpayer is a North Carolina resident during 2020. Taxpayer deducts the entire \$100,000 loss in arriving at federal adjusted gross income. Taxpayer will receive the full benefit of the deduction. There is no proration required as a result of Taxpayer's nonresident status in the year the loss was incurred.

If a taxpayer is a resident during the year the NOL is incurred and a nonresident or part-year resident in the year to which the NOL is carried, the entire loss is sourced to North Carolina. The amount of NOL deducted on the federal return is subtracted on line 15 of both columns of Schedule PN. The full amount of any required North Carolina addition as a result of the NOL not being completely absorbed is added to both Columns A and B on line 3 of Schedule PN-1.

**c. Nonresidents and Part-Year Residents**

If the taxpayer is a nonresident or a part-year resident in the year the NOL is incurred and a nonresident or part-year resident in the year to which the loss is carried, the taxpayer must determine the percentage of the NOL that either was from North Carolina sources while a nonresident or was incurred while a resident (if a part-year resident). The percentage is then multiplied by the amount of NOL absorbed for the year to which the loss is carried. The numerator of the fraction used to calculate North Carolina taxable income is reduced by the result while the denominator is reduced by the portion of the total NOL deducted in that year for federal purposes.

If the taxpayer is a nonresident or a part-year resident in the year the NOL is incurred and a nonresident or part-year resident in the year to which the loss is carried, the taxpayer must also account for the addition required for an unabsorbed portion of an NOL. To do so, the taxpayer must multiply the addition by a fraction. The numerator of the fraction is the portion of the NOL that either was from North Carolina sources while a nonresident or was incurred while a North Carolina resident during the year of the loss. The denominator of the fraction is the total NOL during the year of loss. This amount is entered on line 3 of Column B of Schedule PN-1. The taxpayer also enters the total unabsorbed portion of the NOL on line 3 of Column A of Schedule PN-1.

**Example 1.** A nonresident Taxpayer incurs an NOL of \$100,000 in 2019, \$60,000 of which is from North Carolina sources. Taxpayer carries the NOL forward to 2020 when Taxpayer is a nonresident. Taxpayer's federal taxable income, calculated without regard to the NOL, is \$200,000 in 2020. Taxpayer deducts the full amount of the NOL in 2020.

The 2019 NOL reduces Taxpayer's 2020 adjusted gross income by \$100,000. No additions are required on Taxpayer's 2020 North Carolina return due to the NOL carryforward because the NOL carried to 2020 was less than 80% of Taxpayer's federal taxable income and the NOL was fully absorbed. Taxpayer must use the 2020 Schedule PN to account for the impact of his residency status on the NOL.

On Taxpayer's 2020 Schedule PN, Taxpayer must subtract from the numerator the portion of the NOL that was from North Carolina sources while a nonresident (\$60,000) during the year of the loss. Taxpayer enters this total (-\$60,000) on line 15 (Other Income) of Column B of the 2020 Schedule PN.

Taxpayer must subtract the total NOL deducted on the federal return (\$100,000) from the denominator on the 2020 Schedule PN. Taxpayer enters this amount (-\$100,000) on line 15 (Other Income) of Column A of the 2020 Schedule PN.

**Example 2.** A part-year resident Taxpayer incurs an NOL of \$100,000 in 2019, \$30,000 of which was from all sources while a resident and \$40,000 of which was from North Carolina sources while a nonresident. Taxpayer carries the loss forward to 2020 when he is a nonresident. Taxpayer deducts the NOL of \$100,000 on the 2020 federal return; where it is fully absorbed. Taxpayer's federal taxable income, calculated without regard to the NOL, is \$100,000 in 2020.

The 2019 NOL reduces Taxpayer's 2020 adjusted gross income by \$100,000 and generates a North Carolina addition to adjusted gross income of \$20,000 for the excess NOL carryforward deduction. These adjustments result in an \$80,000 decrease to Taxpayer's North Carolina taxable income. Taxpayer must use the 2020 Schedule PN to account for the impact of his residency status on the NOL adjustments.

On taxpayer's 2020 Schedule PN, taxpayer must subtract from the numerator the portion of the NOL that was from all sources while a resident (\$30,000) and which was from North Carolina sources while a nonresident (\$40,000) during the year of the loss. Taxpayer enters this total (-\$70,000) on line 15, Other Income, of Column B of the 2020 Schedule PN.

Taxpayer must subtract the total NOL deducted on the federal return (\$100,000) from the denominator on the 2020 Schedule PN. Taxpayer enters this amount (-\$100,000) on line 15, Other Income, of Column A of the 2020 Schedule PN.

To account for the addition for the excess NOL carryforward deduction required on the 2020 Schedule PN-1, Taxpayer first multiplies the addition (\$20,000) by a fraction. The numerator of the fraction is the portion of the NOL that was from all sources while a resident (\$30,000) added to the portion of the NOL that was from North Carolina sources while a nonresident (\$40,000) during the year of the loss. The denominator of the fraction is the total NOL during the year of loss (\$100,000). The fraction is calculated as  $0.7 = \$70,000 \text{ divided by } \$100,000$ . Multiplying the total required addition by this amount ( $0.7 \times \$20,000 = \$14,000$ ), Taxpayer determines that \$14,000 should be entered on line 4, Excess Net Operating Loss Carryforward Deduction, of Column B on the 2020 Schedule PN-1. Taxpayer then enters the total amount of the excess NOL carryforward deduction (\$20,000) on line 4 of Column A on the 2020 Schedule PN-1.

## **6. Claiming a Net Operating Loss**

### **a. Carrying back an NOL**

For federal tax purposes, a taxpayer carrying back an NOL may use federal Form 1040X or, if a refund is due, federal Form 1045. North Carolina does not have a form similar to federal Form 1045; therefore, the taxpayer must file an amended North Carolina income tax return to carry back an NOL. A copy of federal Form 1045, including Schedule A,

must be provided with the amended North Carolina return for each year to which the loss is carried back. For any year in which the loss is carried back but not completely absorbed, a copy of Schedule B of federal Form 1045 must also be provided. In lieu of federal Form 1045, a worksheet containing the same information as federal Form 1045 is acceptable.

**b. Carrying an NOL forward.**

For federal tax purposes, a taxpayer carrying an NOL forward reports the loss as “Other Income” on the federal return. A copy of federal Form 1045, Schedule A, or similar worksheet identifying the year in which the NOL was incurred and showing how the NOL was calculated must be attached to each State return to which the loss is carried over. For any year in which the loss is carried over but not completely absorbed, a copy of the Worksheet for NOL Carryover included in federal Publication 536 or a similar worksheet must also be provided.

**c. Nonresidents and part-year residents.**

A taxpayer who is a nonresident or part-year resident in the year to which an NOL is carried over must include a schedule showing the calculation of the amount subtracted in arriving at the numerator of the fraction used to determine North Carolina taxable income.

## **7. Statute of Limitations for Refunds Resulting from NOL Carryback**

For both State and federal tax purposes, the period of time in which a taxpayer may claim a refund resulting from the carryback of an NOL is extended beyond the general period of limitations for claiming a refund. For North Carolina purposes, NOL carrybacks arising in tax years ending after 2017 will not result in a refund for most taxpayers due to North Carolina’s decoupling from the NOL provisions of the CARES Act. Exceptions apply for certain farming losses.

The period of time for claiming a refund from the carryback of an NOL expires three years after the date the return is due, including extensions, for the year in which the loss is incurred, not the year to which the loss is carried. For example, a calendar year taxpayer who incurs an NOL in tax year 2018 and files the 2018 return by April 15, 2019, has until April 15, 2022, to file a claim for refund for tax year 2016 because of the carryback of the NOL.

## **8. Calculation of Interest on Overpayments**

For State purposes, [interest](#) accrues on an overpayment of individual income tax from a date 45 days after the latest of the following: (1) the date the final return is filed; (2) the date the final return was due to be filed, including extensions; (3) the date of the overpayment, until the refund is paid. The date of the overpayment of a tax is determined in accordance with section 6611(d), (f), (g), and (h) of the Internal Revenue Code. When a taxpayer claims a refund resulting from the carryback of an NOL, the date of the overpayment is the later of the date the



income tax return for the year in which the loss was incurred is filed; the date the income tax return for the year in which the loss was incurred was due to be filed, not including extensions; or the date the claim for overpayment is filed.

**Note:** For North Carolina purposes, NOL carrybacks arising in tax years ending after 2017 will not result in a refund for most taxpayers due to North Carolina's decoupling from the NOL provisions of the CARES Act. There is a limited exception that applies to certain farming losses.

## XXII. Excess Business Losses

### 1. General

#### a. Federal Law

The Tax Cuts and Jobs Act (“TCJA”) amended section 461 of the Code to add subsection (l), which eliminated the ability of an individual to deduct trade or business losses greater than \$250,000 (\$500,000 for individuals filing a joint return) in any year that begins after December 31, 2017. These amounts are indexed to inflation and adjusted annually. The amount of business loss exceeding the 461(l) limitation is referred to as an “Excess Business Loss.” Excess business losses that were disallowed under 461(l) were treated as a net operating loss carryover to the following taxable year.

The Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) deferred the effective date of the excess business loss limitation to tax years beginning on or after January 1, 2021. This eliminated the excess business loss provisions for tax years 2018 through 2020. Thus, for federal income tax purposes, an individual can fully deduct their business losses for tax years 2018 through 2020. Businesses losses now allowed for these tax years may generate net operating losses which can also be carried back for five years under the provisions of the CARES Act. See [Net Operating Losses](#) for more information.

#### b. North Carolina Decoupling

The General Assembly chose not to adopt the CARES Act deferment of the excess business loss provisions of section 461(l) of the Code. Instead, for North Carolina tax purposes, the excess business loss rules for individuals as defined in section 461(l) of the Code, pre-CARES Act, continue to apply for tax years 2018 through 2020.

[G.S. § 105-153.5\(c2\)\(12\)](#) requires an individual, for taxable years 2018, 2019, and 2020, to add to AGI an amount equal to the individual’s excess business loss, as defined under the provisions of section 461(l) of the Code as enacted as of January 1, 2019.

**Note:** The addition under [G.S. § 105-153.5\(c2\)\(12\)](#) is not required to the extent an individual’s excess business loss was added to AGI under [G.S. § 105-153.5\(c2\)\(8\), \(9\), or \(10\)](#). Moreover, federal law provides that Qualified Improvement Property (“QIP”) placed in service after 2017 now generally qualifies for 100% bonus depreciation under the CARES Act. North Carolina requires an individual to add back federal bonus depreciation in accordance with G.S. § 105-153.6. QIP bonus depreciation should not be included in the calculation of the individual’s excess business loss to the extent the QIP bonus depreciation resulted in an addition to AGI pursuant to G.S. § 105-153.6(a).

[G.S. § 105-153.5\(c2\)\(15\)](#) provides a deduction from AGI for the amount of excess business losses required to be added to AGI under [G.S. § 105-153.5\(c2\)\(12\)](#). An individual may

deduct 20% of the amount added to an individual's AGI in tax years 2018 through 2020, in each of the first five taxable years beginning on or after January 1, 2021.

For additional information, please review the Department's [Important Notice, North Carolina's Reference to the Internal Revenue Code Updated - Impact on North Carolina Corporate and Individual Income Tax Returns](#).

*Reference:* [Session Law 2020-58](#).

## 2. Calculating the Excess Business Loss for 2020

### a. Instructions

An excess business loss is the amount by which a taxpayer's total deductions from trades or businesses are more than the taxpayer's total gross income or gains from trades or businesses, plus the threshold amount. For 2020, the threshold amount is \$259,000 (\$518,000 for married taxpayers filing a joint return).

Non-corporate taxpayers whose net losses from all trades or businesses exceed \$259,000 (\$518,000 for married taxpayers filing a joint return) should complete the worksheet in subdivision (b) of this section to determine their 2020 excess business loss for North Carolina purposes.

When determining an excess business loss, the ordering rules are as follows: First apply the at-risk rules; next, apply the passive activity loss rules; and then apply the excess business loss rules.

For additional information, please review the federal [Form 461 Instructions](#) for tax year 2019.

**Note:** Because excess business loss provisions of Code section 461(l) were suspended for tax year 2020 prior to the publication of the 2020 federal Form 461, the IRS did not publish the 2020 federal Form 461 and instructions. However, as North Carolina adopted the provisions of section 461(l) of the Code as enacted as of January 1, 2019, the information contained in the 2019 federal instructions remains relevant for taxpayers calculating a 2020 excess business loss for North Carolina purposes. The threshold amount for the excess business loss limitation was updated for 2020 by [Rev. Proc. 2019-44](#).

**b. 461(l) Excess Business Loss Addition Worksheet**

Excess Business Loss Addition Worksheet	
<b><u>Part I: Total Income/Loss Items</u></b>	
1. Enter amount from Form 1040 or 1040-SR, line 1 .....	1. _____
2. Enter amount from Schedule 1 (Form 1040 or 1040-SR), line 3 .....	2. _____
3. Enter amount from Form 1040 or 1040-SR, line 7 .....	3. _____
4. Enter amount from Schedule 1 (Form 1040 or 1040-SR), line 4 .....	4. _____
5. Enter amount from Schedule 1 (Form 1040 or 1040-SR), line 5 .....	5. _____
6. Enter amount from Schedule 1 (Form 1040 or 1040-SR), line 6 .....	6. _____
7. Enter amount from Schedule 1 (Form 1040 or 1040-SR), line 7 .....	7. _____
8. Enter other income, gain, or losses from a trade or business not reported on lines 1 through 7.....	8. _____
9. Combine lines 1 through 8 .....	9. _____
<b><u>Part II: Adjustment for Amounts Not Attributable to Trade or Business</u></b>	
10. Enter any income or gain reported on lines 1 through 8 that is not attributable to a trade or business.....	10. _____
11. Enter any losses or deductions reported on lines 1 through 8 that are not attributable to a trade or business (Although losses and deductions usually are entered as negative figures on other forms or worksheets, enter them as a positive figure on this line).....	11. _____
12. Subtract line 11 from line 10.....	12. _____
<b><u>Part III: Limitation on Losses</u></b>	
13. If line 12 is a negative number, enter it here as a positive number. If line 12 is a positive number, enter it here as a negative number .....	13. _____
14. Add lines 9 and 13 .....	14. _____
15. Enter \$259,000 (or \$518,000 if married filing jointly) .....	15. _____
16. Add lines 14 and 15.....	16. _____
If Line 16 is less than zero, you will have an excess business loss addition on your North Carolina return. Enter the amount from line 16 as a positive number on North Carolina Schedule S, Line 12.	
If Line 16 is zero or greater, you will not have an excess business loss addition on your 2020 North Carolina return.	

**c. Examples**

**Example 1:** Taxpayer’s filing status is single for 2020. Taxpayer calculates a business loss for tax year 2020 of \$359,000. On Taxpayer’s 2020 federal return, Taxpayer is able to use the loss to offset \$400,000 of non-business income.

Taxpayer calculates an excess business loss of \$100,000 for North Carolina purposes (\$359,000 business loss - \$259,000 threshold for 2020). On Taxpayer’s 2020 North Carolina individual income tax return, Taxpayer will make an addition to AGI of \$100,000. Taxpayer will be able to deduct \$20,000 (20% of the \$100,000 addition) per year for five years beginning with the 2021 tax year.

**Example 2:** Taxpayer's filing status is single for 2020. Taxpayer calculates a business loss for tax year 2020 of \$359,000. On Taxpayer's 2020 federal return, Taxpayer uses the loss to offset \$300,000 of other income. The remainder of the loss, \$59,000, is carried back as a net operating loss to tax year 2015 (where it is fully absorbed) under the net operating loss provisions of the CARES Act.

Taxpayer determines that he will have a \$59,000 addition on his 2015 North Carolina return for the carried back net operating loss under G.S. § 105-153.5(c2)(10). Taxpayer also calculates a 2020 excess business loss of \$100,000 for North Carolina purposes (\$359,000 business loss - \$259,000 threshold for 2020).

To determine the amount of his 2020 excess business loss addition, Taxpayer subtracts from his excess business loss the portion of the excess business loss that is added back under G.S. § 105-153.5(c2)(10). Of the Taxpayer's \$100,000 excess business loss, \$59,000 was included in the net operating loss carried to 2015. Consequently, Taxpayer will make an excess business loss addition to AGI of only \$41,000 for 2020.

Taxpayer will be able to deduct \$8,200 (20% of \$41,000) per year for five years beginning with the 2021 tax year for his excess business loss. Also note that Taxpayer will be able to deduct \$11,800 (20% of the \$59,000) per year for five years beginning with the 2021 tax year for his net operating loss carryback addition.

**Example 3:** Taxpayer's filing status is married filing jointly for 2019. Taxpayer has a business loss for tax year 2019 of \$610,000 and \$750,000 of other income. On Taxpayer's 2019 federal return, Taxpayer calculated an excess business loss of \$100,000. As a result, only \$510,000 of his business loss was utilized to offset other income. Taxpayer also placed Qualified Improvement Property ("QIP") in service during 2019. After the enactment of the CARES Act, Taxpayer's QIP property qualifies for 100% bonus depreciation and the excess business loss limitation no longer applies at the federal level.

In 2020, Taxpayer amends his 2019 federal return and now shows a business loss of \$710,000 (\$610,000 plus \$100,000 QIP bonus depreciation). Taxpayer determines that he will have a \$100,000 addition on his amended 2019 North Carolina return for the new QIP bonus depreciation under G.S. § 105-153.6(a).

**Important:** To calculate his 2019 excess business loss for North Carolina purposes, Taxpayer will not include the amount of QIP bonus depreciation in the calculation of his excess business loss. Consequently, Taxpayer calculates a 2019 excess business loss addition of \$100,000 for North Carolina purposes (\$610,000 business loss without QIP - \$510,000 threshold for 2019).

Taxpayer will be able to deduct \$20,000 (20% of \$100,000) per year for five years beginning with the 2021 tax year for his excess business loss. Also note that Taxpayer will be able to deduct \$20,000 (20% of \$100,000) per year for five years beginning with the 2021 tax year for his QIP bonus depreciation addition.

# **XXIII. Taxable Status of Distributions from Regulated Investment Companies**

## **1. General**

Distributions from a regulated investment company (“mutual fund”) other than “capital gain distributions” and “exempt interest dividends” are included in adjusted gross income in the same manner as distributions of other corporations. Distributions from earnings and profits are ordinary dividends (taxable dividends) unless the mutual fund notifies the taxpayer to the contrary.

Capital gain distributions are paid by mutual funds from their net realized long-term capital gains. Individuals receiving a capital gain distribution must report the distribution as a long-term capital gain on their federal income tax return.

*Reference:* [17 NCAC 06B .4101](#).

## **2. Exempt Interest Dividends**

A mutual fund is qualified to pay exempt interest dividends only if at the close of each quarter of its taxable year at least 50% of the value of the total assets of the company consisted of state and local bonds, the interest from which is exempt from federal income tax, and certain other obligations on which the interest is exempt from federal income tax under provisions of federal law other than the Internal Revenue Code, as those provisions of the law were in effect on January 6, 1983. A mutual fund paying exempt interest dividends to its shareholders must send its shareholders a statement within 60 days after the close of the taxable year showing the amount of exempt interest dividends. The exempt interest dividends are not required to be included in adjusted gross income.

Exempt interest dividends paid by a mutual fund to a shareholder and not included in the shareholder’s adjusted gross income shall be added to adjusted gross income to the extent it represents interest on obligations of states, other than North Carolina, and their political subdivisions. The total distribution designated as exempt interest dividends by a mutual fund shall be added to adjusted gross income in computing the shareholder’s North Carolina taxable income unless the mutual fund provides a statement to the shareholder that designates the portion of the exempt interest dividends that represents interest from obligations of the State of North Carolina or its political subdivisions or the United States or its possessions.

## **3. Ordinary Dividends**

Interest in the form of dividends from mutual funds is deductible from an individual’s adjusted gross income to the extent the distributions represent interest on direct obligations of the United States Government. Interest earned on obligations that are merely backed or guaranteed by the United States Government do not qualify for the deduction. Further, this deduction does not

apply to distributions that represent gain from the sale or other disposition of the securities nor to interest paid in connection with repurchase agreements issued by banks and savings and loan associations.

The taxpayer may not deduct mutual fund dividends on the basis of a percentage of investments held by the fund (i.e., a fund has 75% of its investments in United States Treasury Notes). The fund must furnish the shareholder a statement verifying the amount of interest paid to the shareholder that accrued from direct obligations of the United States Government. The statement to support the deduction must specify the amount of the dividend to the shareholder that represents interest on direct obligations of the United States Government.

This procedure will also apply with respect to interest on obligations of the State of North Carolina and any of its political subdivisions to the extent included in adjusted gross income.

*Reference:* [17 NCAC 06B .4103](#).

#### **4. Capital Gain Distributions**

The portion of distributions from a mutual fund that represents capital gain is reportable on the federal income tax return as capital gain income and not dividend income. Under [G.S. § 105-153.5\(b\)\(2\)](#), capital gain distributable to a shareholder who is a resident of North Carolina and attributable to the sale of an obligation issued before July 1, 1995, the profit from which is exempt by North Carolina statute, is deductible from federal adjusted gross income in determining the North Carolina taxable income of an individual, trust or estate.

## **XXIV. Miscellaneous**

### **1. Deposit of Payment**

When a payment is received by the Department of Revenue for less than the correct tax, penalty, and interest due under the law and the facts and the payment includes the statement, “paid in full” or other similar statements, the payment will be deposited as required by [G.S. § 147-77](#). The endorsement and deposit of the payment with such statement will not make the statement binding on the Department of Revenue and will not prevent the collection of the correct balance due.

*Reference:* [G.S. § 147-77](#).

### **2. Photograph, Photocopy, and Microphotocopy of Records**

The Department is authorized by law to photograph, photocopy, or microphotocopy all records, including tax returns, and such copies, when certified by the Department as true and correct copies, shall be as admissible in evidence in all actions, proceedings, and matters as the original would have been. For more information, see [G.S. § 8-45.3](#).

*Reference:* [G.S. § 8-45.3](#).

### **3. Setoff Debt Collection**

In some cases debts owed to certain State, local, and county agencies will be collected from an individual’s income tax refund. If the agency files a claim with the Department for a debt of at least \$50.00 and the refund is at least \$50.00, the debt will be set off and paid from the refund. The Department will notify the debtor of the set-off and will refund any balance which may be due. The agency receiving the amount set-off will also notify the debtor and give the debtor an opportunity to contest the debt. If an individual has an outstanding federal income tax liability of at least \$50.00, the Internal Revenue Service may claim the individual’s North Carolina income tax refund. For more information, see [G.S. § 105-241.7\(e\)](#) and the [Setoff Debt Collection Act](#) of Chapter 105A of the North Carolina General Statutes.

*Reference:* [Chapter 105A](#); [G.S. § 105-241.7\(e\)](#).

### **4. North Carolina Nongame and Endangered Wildlife Fund**

An individual may elect to contribute all or any portion of an income tax refund (at least \$1.00 or more) to the North Carolina Nongame and Endangered Wildlife Fund. Once the election is made to contribute, the election cannot be revoked after the return has been filed. The tax deductible contributions are essential to match private and federal grants to pay for conservation projects for sea turtles to songbirds, from native fish to bats. Conserving these species and their habitat is made possible by taxpayer contributions. If a taxpayer is not due a refund, the taxpayer may still contribute to the Fund by mailing a donation directly to the North



Carolina Wildlife Resources Commission, 1702 Mail Service Center, Raleigh, North Carolina 27699-1700. Checks may be made payable to the Nongame and Endangered Wildlife Fund. For more information, see [G.S. § 105-269.5](#).

*Reference:* [G.S. § 105-269.5](#).

## **5. North Carolina Education Endowment Fund**

A taxpayer entitled to a refund of income taxes, or a taxpayer who desires to make a contribution, may elect to contribute all or part of their refund or make a contribution to the North Carolina Education Endowment Fund established pursuant to [G.S. § 115C-472.16](#) to be used in accordance with that statute. Once the election is made to contribute, the election cannot be revoked after the return is filed. Additional contributions to the fund may be made by mailing a donation directly to the North Carolina Department of Public Instruction, Cash Collections, 6336 Mail Service Center, Raleigh, North Carolina 27699-6336. Checks should be made payable to “North Carolina Department of Public Instruction” with an indication either on the check or in an attached note that it is a contribution for the NC Education Endowment Fund. For more information, see [G.S. § 105-269.7](#).

*Reference:* [G.S. § 105-269.7](#).

## **6. North Carolina's Breast and Cervical Cancer Control Program**

An individual entitled to a refund of income taxes may elect to contribute all or part of the refund to the North Carolina Cancer Prevention and Control Branch of the Division of Public Health of the Department of Health and Human Services to be used for early detection of breast and cervical cancer. Once the election is made to contribute, the election cannot be revoked after the return has been filed. Refunds contributed shall be used only for early detection of breast and cervical cancer and shall be used in accordance with North Carolina's Breast and Cervical Cancer Control Program's (“NC BCCCP”) policies and procedures. If you are not due a refund, you may still contribute to the NC BCCCP by mailing a donation directly to N.C. Cancer Prevention and Control Branch of the Division of Public Health of the Department of Health and Human Services, 1922 Mail Service Center, Raleigh, North Carolina 27699-1922. Checks should be made payable to “North Carolina Department of Health and Human Services” with an indication either on the check or in an attached note that it is a contribution for the N.C. Breast and Cervical Cancer Control Program Fund.

*Reference:* [G.S. § 105-269.8](#).

## **7. Refund Applied to Estimated Tax**

An individual may elect to have an income tax refund applied to estimated income tax for the following year. For example, an individual due a refund on the 2020 income tax return may have all or any portion of the refund applied to his or her estimated tax for 2021. The individual may not, however, file a 2020 tax return in 2022 and request the refund be applied to 2022

estimated tax since the refund can only be applied to the tax year which follows the tax year for which the request for refund is made. The last allowable date for making a 2021 estimated tax payment is January 15, 2022; therefore, you must file your 2020 income tax return by January 15, 2022, to elect to apply a portion of your refund to 2021 estimated tax.

If an individual makes a valid election, that individual may not revoke the election in order to have the amount refunded or applied in any other manner, such as an offset against any subsequently determined tax liability.

*Reference:* [G.S. § 105-269.4.](#)

## **8. Substantiating Documentation**

Canceled checks, receipts, or other evidence to substantiate deductions on the tax return should be kept for a period of at least three years from the due date of the return or three years from the date the return is filed, whichever is later. Lack of adequate records could result in the disallowance of all or part of the deductions claimed. A canceled check, money order stub, or Departmental receipt showing payment of tax should be kept for at least five years from the due date of the tax return.

*Reference:* [G.S. § 105-251\(a\).](#)

## **9. Report of Sale of Real Property by Nonresidents**

Every individual, fiduciary, partnership, corporation, or unit of government buying real property located in North Carolina from a nonresident individual, partnership, estate or trust is required to complete [Form NC-1099NRS](#), Report of Sale of Real Property by Nonresidents, reporting the seller's name, address, and social security number, or federal employer identification number; the location of the property; the date of closing; and the gross sales price of the real property and its associated tangible personal property. Within fifteen days of the closing date of the sale, the buyer must file the report with the Department of Revenue and furnish a copy of the report to the seller.

*Reference:* [17 NCAC 06B .3906.](#)

## **10. Use Tax**

North Carolina use tax is due to be paid by individuals and businesses on the following items if the seller fails to collect the applicable sales tax:

1. Tangible personal property purchased, leased or rented inside or outside this State for storage, use, or consumption in this State. This includes tangible personal property that becomes part of a building or another structure.
2. Certain digital property purchased inside or outside this State for storage, use, or consumption in this State.
3. Services sourced to this State.

For filing requirements and a list of common items on which sales and use tax may not have been collected and where use tax may be due by the purchaser, see [Use Tax](#).

*Reference:* [G.S. § 105-164.6](#).

## **11. Tenancy by the Entirety**

When filing separate returns, a determination must be made as to that portion of the income or loss from real property that must be reported by each spouse. Under [G.S. § 39-13.6](#), a married couple has equal right to the control, use, possession, rents, income, and profit from real property held as tenants by the entirety and each spouse is taxed on one-half of the income or loss from such property located in North Carolina. When real property conveyed jointly in the name of a married couple is located in another state and the share of ownership of each is not fixed in the deed or other instrument creating the co-tenancy, each spouse is considered as having received one-half of the income or loss from the real property unless they can demonstrate that the laws of that particular state with respect to the right to the income from the property allocate the income or losses in a different manner.

*Reference:* [17 NCAC 06B .0119](#).

## **12. Community Property**

If a married couple is domiciled in a state or country recognized for federal income tax purposes as a community property state or country and the spouses file separate North Carolina returns with each spouse reporting one-half of the salary and wages received while domiciled in the community property state or country, each spouse shall claim one-half of the credit for the income tax withheld with respect to community wages. A schedule or statement must be attached to the North Carolina return showing the name and social security number of each spouse, that they were domiciled in a community property state or country, and that 50 percent of each spouse's income tax withheld is allocated to the other spouse's income tax return.

*Reference:* [17 NCAC 06B .0113](#).

## **13. Claim of Right Income Credit**

A taxpayer who elects for federal tax purposes to take a federal tax credit in lieu of a tax deduction because the taxpayer was required to repay income under a Claim of Right may be entitled to a claim of right tax credit for North Carolina tax purposes under [G.S. § 105-266.2](#). For more information, see federal Publication 525 and [Repayment of Right Income](#). Form D-401 includes a “Repayment of Claim of Right Worksheet” for taxpayers who elect to take a tax deduction instead of a tax credit. See [Claim of Right Income Deduction](#).

*Reference:* [G.S. § 105-266.2](#).

## **XXV. Taxpayers' Bill of Rights**

As a taxpayer, you are always entitled to fair, professional, prompt, and courteous service. Our goal is to apply the tax laws consistently and fairly so that your rights are protected and that you pay only your fair share of North Carolina tax. For more information, see [North Carolina Taxpayers' Bill of Rights](#).