2001
North Carolina
C Corporation Tax Return Instructions

Important Legislative Changes Affecting 2001 Returns

1. **Royalty Reporting Option**

   Under new G.S. 105-130.7A, if the recipient of North Carolina royalty income is related to the payer, the North Carolina royalty payments may be reported in either of two ways. First, the recipient of the payments can include the payments in its North Carolina income and the company making the payments can deduct the payments from the company's North Carolina income. Second, the recipient of the payments can exclude the payments from its North Carolina income and the company making the payments can add the payments to the company's North Carolina income. Royalties from the use of trademarks in this State are income derived from doing business in this State and are subject to North Carolina income tax.

2. **Franchise Tax and Limited Liability Companies**

   New G.S. 105-114(c) requires a corporation that is a member of a limited liability company (LLC) and is entitled to receive at least 70% of the LLC's assets upon dissolution to include the LLC's assets in the corporation's franchise tax base.

3. **Subsidiary Dividends**

   G.S. 105-130.5(a)(7) and G.S. 105-130.7(b) were repealed. The repeal eliminates North Carolina's separate dividend received deduction. G.S. 105-130.5(b) was amended to add new provisions on foreign dividends. The result of these changes is that North Carolina allows the same dividend deduction as under federal law, net of expenses. For an acceptable means of computing related expenses, see 17 N.C.A.C. 5C .304, Attribution of Expenses, Nontaxable Income, and Nonbusiness Income and Property.

4. **Changes to Article 3A Tax Incentives for New and Expanding Businesses**

   Several changes effective for tax year 2001 were made to the tax incentives for new and expanding businesses, including new conditions for eligibility. For detailed information concerning these changes, check our website, www.dor.state.nc.us, under 2001 Tax Law Changes. Detailed instructions for the NC-478 and the NC-478A-H series are also available on the Department's website.

General Information

The information contained in this booklet is to be used as a guide in the preparation of the North Carolina C-Corporation tax return and is not intended to cover all provisions of the law.

Corporations Required to File

Every corporation doing business in North Carolina and every inactive corporation chartered or domesticated here must file an annual franchise and income tax return using the name reflected on the corporate charter if incorporated in this State, or on the certificate of authority if incorporated outside this State. A franchise tax is imposed on corporations for the privilege of doing business in this State even though the activities are exempt from income tax under P.L. 86-272. For a corporation that is subject to both income tax and franchise tax, its apportionment factor is the same for both taxes. For a corporation that is subject to franchise tax but not income tax, its apportionment factor for computing the amount of franchise tax due is the same factor that would be used if its activities that are protected by P.L. 86-272 were subject to income tax in this State. **Important: Telephone companies previously subject to the gross receipts franchise tax under G.S. 105-120 are now subject to general business franchise tax under G.S. 105-122.**

New Corporations

A new corporation (newly incorporated, newly domesticated out-of-state corporation, or other corporation commencing business in the State) is required to file a combined franchise and income tax return with this Department within seventy-five (75) days following the close of its first income year of twelve (12) months or less. The taxable year for a new corporation in this State is presumed to end the calendar month preceding the month of incorporation unless otherwise established by the filing of the required return indicating the taxable year adopted. In no case may the first taxable year exceed 12 months unless it is clearly shown that the corporation has adopted a method of accounting using the 52-53 week reporting period. A franchise and income tax return is due annually so long as the corporation remains incorporated, domesticated, or continues to do business in this State.

Tax Rates

The franchise tax rate is $1.50 per $1,000.00 of capital stock, surplus, and undivided profits or other alternative tax base. The minimum franchise tax is $35.00 with no maximum except for qualified holding companies. The corporate income tax rate is 6.90% of net income attributed to N.C.

When and Where to File

Franchise and income tax returns are due on the 15th day of the third month following the close of the income year. Income tax returns for cooperative or mutual associations are due on or before the 15th day of the ninth month following the close of the income year; however, these corporations, if subject to franchise tax, must file a franchise tax return by the 15th day of the third month following the close of the income year. **Returns should be filed with the North Carolina Department of Revenue, P.O. Box 25000, Raleigh, NC, 27640-0500 or at one of the Department's local branch offices.**

Extensions

An extension of time to file the franchise and income tax return may be granted for seven (7) months if the extension application is received timely. Without a valid extension, a return filed after the statutory due date will be delinquent and subject to interest and all applicable penalties provided by law. **To receive an extension, taxpayers must file Form CD-419, Application for Extension, by the original due date of the return**. *(For detailed information, see the separate instructions for this form available from the Department.)*

A properly filed federal extension does not constitute a N.C. extension.

Estimated Income Tax

Corporations that expect to have an income tax liability to this State of $500 or more are required to file Form CD-429, Corporate Estimated Income Tax, and pay 90% of the estimated tax. *(For more information on estimated tax payments, including time of payment, amount of payment, and underpayment penalties, see the instructions for this form.)*

To avoid unnecessary delays, use the preaddressed Form CD-429 when furnished by the Department. A generic Form CD-429 is available from the Department's website and may be used if you did not receive a preaddressed form.

Specific Instructions for Filing Form CD-405

Period Covered

File the 2001 return for calendar year 2001 and fiscal years that begin in 2001. For tax years of less than 12 months, fill in the circle at the top of the form.

Demographic and Other Taxpayer Information

Name, Address, and Identification Numbers. Print or type the corporation's true legal name (as set forth in the corporate charter), address, federal identification number, and N.C. Secretary of State number on the appropriate lines. Include in this section the corporation's primary NAICS code as determined by the N.C. Employment Security Commission. *(For further information regarding the NAICS code, see the North American Industry Classification System as published by the Federal Office of Management and Budget)*

If a change in address occurs after the return is filed, use Form NC-AC, Business Address Correction, to notify the Department of the new address.

Gross Receipts/Sales and Total Assets. Enter the corporation's gross receipts or sales from all business operations for the tax year. Also enter the corporation's total assets (as determined by the accounting method regularly used in keeping the corporation's books and records) at the end of the tax year.

Amended return. If filing an amended return, fill in the appropriate circle. A complete explanation as to the reason(s) for filing an amended return, including specific schedule and line number references, must be included on Schedule J of the return. If any change is made to corporate net income by the Internal Revenue Service, taxpayers are required to file an amended return with N.C. within two (2) years after being notified of the correction or final determination. A penalty is imposed for failure to comply with this filing requirement.

Initial return. If this is the corporation's first return in N.C., fill in the appropriate circle.

Final return. If the corporation ceases to exist or leaves N.C. during the tax year, fill in the appropriate circle. Since franchise taxes are paid in advance or at the beginning of the income year, corporations are not subject to franchise tax after the end of the income year in which articles of dissolution or withdrawal are filed with the Secretary of State unless they engage in business activities not reasonably incidental to winding up their affairs. Although the final income tax return must be filed on a combination franchise and income tax return form, the schedules relating to franchise tax should be disregarded. This applies, however, only to those corporations officially filing articles of dissolution or withdrawal with the Secretary of State of North Carolina.

Limited Liability Companies. If a corporation is registered as a limited liability company, fill in the appropriate circle. **Important:** A corporation that is a member of a limited liability company and is entitled to 70% or more of the limited liability company's assets upon dissolution must include its percentage of the limited liability company's income, assets, liabilities, and equity in its computation of franchise tax. *(For more information, see **2001 Tax Law Changes** available on the Department's website.)*

CD-479 (Annual Report). All domestic corporations and foreign corporations authorized to transact business in North Carolina except for insurance companies, limited liability companies, nonprofit corporations, professional corporations, and professional associations must, on an annual basis, complete Form CD-479 and remit a twenty dollar ($20.00) fee. The annual report, Form CD-479, must be completed in its entirety and placed on **the front page** of the completed tax return. Failure to submit the Annual Report with the tax return may result in an administrative dissolution of the Corporate Articles or Certificate of Authority by the Secretary of State's Office as prescribed by statute. If the corporation's annual report has been attached to Form CD-405, fill in the appropriate circle.

Nonprofit Entities. Certain corporations organized under Chapter 55A are exempt from franchise tax and income tax under G.S. 105-125 and 105-130.11, respectively. However, these corporations are not exempt on "unrelated business income" earned in excess of $1000 annually. The term "unrelated business income" is the same as defined under the Internal Revenue Code. Income tax returns for nonprofit entities are due on or before the 15th day of the fifth month following the close of the tax year. If a corporation is incorporated as a nonprofit entity, fill in the appropriate circle.

NC-478. Corporations claiming a credit limited by statute to 50% of tax must complete Form NC-478, Summary of Tax Credits Limited to 50% of Tax, and place it on the front of the completed Form CD-405. If the corporation has attached Form NC-478 to Form CD-405, fill in the appropriate circle.

Check-the-Box and QSSS Requirements. For corporate income tax purposes, N.C. follows the federal classification of entities under the federal check-the-box regulations. If the corporation meets these qualifications, fill in the appropriate circle. **Qualified Subchapter S Subsidiaries must file separate franchise tax returns (CTAM-97-13).**

Escheatable (Abandoned or Unclaimed) Property. Every corporation holding property of N.C. residents that is unclaimed and abandoned under General Statutes Chapter 116B must certify the holding of the escheatable property on its income tax return by filling in the appropriate circle. For questions about abandoned and unclaimed property, call (919) 508-5979 or write to: **Escheat Officer, Department of State Treasurer, Albemarle Building, 325 N. Salisbury Street, Raleigh, North Carolina 27603.**

Computation Of Franchise Tax - Schedule A

Lines 1 through 5 - Tax Bases

Franchise tax is computed by applying the tax rate of $1.50 per $1,000.00 to the largest of the following three bases:

(1) Capital stock, surplus, and undivided profits (Schedule C)
(2) Actual investment in tangible property in N.C. (Schedule D)
(3) Fifty-five percent of appraised ad valorem tax value of all tangible property in N.C. (Schedule E).

The minimum franchise tax is thirty-five dollars, ($35.00). Follow the specific instructions for each schedule to determine the amount of each tax base.

Inactive Corporations. A corporation that is inactive and without assets is subject annually to a minimum franchise tax of $35. A return containing a statement of the status of the corporation is required to be filed. Failure to file this return and pay the minimum tax will result in suspension of the articles of incorporation or certificate of authority. Any corporation that intends to dissolve or withdraw through suspension for nonpayment of franchise tax should indicate its intention in writing to the Department.

Capital stock, surplus, and undivided profits. Enter the amount of capital stock, surplus, and undivided profits from the book balance sheet as of the end of the tax year. Before making this entry, corporations must complete Schedule C of Form CD-405 *(See instructions on Page 7)*

Qualified Holding Companies. Franchise tax payable by qualified holding companies on its capital stock and surplus tax base is limited to an amount not to exceed $75,000. There is no limitation on the amount of franchise tax payable where the alternative tax bases of investment in tangible property or appraised value of property apply. If the corporation qualifies as a holding company for franchise tax purposes, enter the amount of capital stock in the box and fill in the circle next to the box.

Actual investment in tangible property in N.C. Enter the amount of actual investment in tangible property in N.C. from the book balance as of the end of the tax year. Before making this entry, corporations must complete Schedule D of Form CD-405 *(See instructions on Page 7)*

Appraised ad valorem tax value of all tangible property in N.C. Multiply the appraised ad valorem tax value of all tangible property located in N.C. by 55%. Before making this entry, corporations must complete Schedule E of Form CD-405 *(See instructions on Page 7)*

Line 6a - Application for Franchise Tax Extension

If the corporation filed an application for franchise tax extension, Form CD-419, enter the amount of **franchise tax paid** with the extension on Line 6a. *(See Form CD-419, Line 1)*

Line 6b - Tax Credits

To claim a franchise tax credit on Line 6b, corporations must complete Form CD-425, Corporate Tax Credit Summary, and file it with the tax return. Taxpayers claiming a credit limited by statute to 50% of tax must also complete Form NC-478, Summary of Tax Credits Limited to 50% of Tax, and place it on the front of the completed tax return. A computational worksheet for investing in business property, Form NC-478F, is enclosed in this booklet. Computational worksheets for many of the remaining tax incentives are available from the Department's website.

The following is a list of the more utilized franchise tax credits:

- Short Period Franchise Tax Credit
- Machinery & Equipment Investment Tax Credit
- Job Creation Tax Credit
- Research and Development Tax Credit
- Worker Training Tax Credit
- Central Office or Aircraft Facility Property Tax Credit
- Business Property Tax Credit
- Investing in Renewable Energy Property Tax Credit
- Low-Income Housing Tax Credit

(For specific information regarding each of these credits, refer to the Franchise Tax and Corporate Income Tax Rules and Bulletins.)

Mergers. Since franchise tax is prepaid, a special computation is sometimes required to prevent a duplication of tax when two or more corporations with different income years merge or otherwise transfer the entire assets from one corporation to the other. *(For specific information and the procedure for making this computation, refer to the Franchise Tax and Corporate Income Tax Rules and Bulletins.)*

Lines 7 and 8 - Franchise Tax Due / Overpaid

Subtract Lines 6a and 6b from Line 5. If the total of Line 6a plus 6b is less than Line 5, **additional franchise tax is due**. Enter the amount of additional tax due on Line 7 and on Page 2, Line 35. If the amount of 6a plus 6b is more than Line 5, **franchise tax is overpaid**. Enter the amount of overpayment on Line 8 and on Page 2, Line 35. **Fill in the circle located next to the box on Line 35 to indicate that the amount is an overpayment.**

(Overpaid franchise tax can offset underpaid income tax in the same tax year and vice versa. See Tax Due or Refund section for line-by-line instructions.)

Schedule B - Computation of Income Tax

Line 9 - Federal Taxable Income

Enter the amount of federal taxable income before the net operating loss deduction from Schedule G, Line 30, or from Federal form 1120, Line 28 minus Line 29b. **If the amount on Line 9 is negative, enter the amount in the box and fill in the circle located next to the box to indicate that the amount is negative. Do not use brackets or other symbols to indicate a negative number.**

Line 10 - Adjustments to Federal Taxable Income

Taxpayers must make certain adjustment to federal taxable income in arriving at N.C. net income. Before making this entry, corporations must complete Schedule H of Form CD-405. *(See instructions on Page 7)* **If the amount on Line 10 is negative, enter the amount in the box and fill in the circle located next to the box to indicate that the amount is negative.**

Line 12 - Contributions

Subject to certain limitations, corporations may deduct contributions or gifts made within the income year to qualified donees when determining State net income. N.C. law does not permit a corporation to carry over unused contributions to subsequent tax years. Before making this entry, corporations must complete Schedule I of Form CD-405. *(For specific information regarding the deduction of contributions, refer to the Franchise Tax and the Corporate Income Tax Rules and Bulletins.)*

Line 14 - Nonbusiness Income

When a corporation has income from sources within N.C. as well as sources outside N.C., a determination of business and nonbusiness income must be made. Enter on Line 14 the corporation's total nonbusiness income. Before making this entry, corporations must complete Schedule N of Form CD-405. *(See instructions on Page 8)* **If the amount on Line 14 is negative, enter the amount in the box and fill in the circle located next to the box to indicate that the amount is negative.**

Line 16 - Apportionment Factor

Enter the apportionment factor percentage as calculated from Schedule O of Form CD-405. **The apportionment factor must be calculated four places to the right of the decimal.** *(See instructions on Page 9)*

Line 18 - Nonbusiness Income Allocated to N.C.

Enter on Line 18 the amount of nonbusiness income allocated directly to this State. Before making this entry, corporations must complete Schedule N of Form CD-405. *(See instructions on Page 8)* **If the amount on Line 18 is negative, enter the amount in the box and fill in the circle located next to the box to indicate that the amount is negative.**

Line 21 - Net Economic Loss

Corporations that are required to apportion their net income or loss under G.S. 105-130.4 may carry forward to the succeeding year only the allocated portion of the loss less a proportionate amount of any nontaxable income received in the loss year. The amount of any nontaxable income received in the succeeding year multiplied by the succeeding year's apportionment percentage must be deducted from the loss brought forward in determining the allowable net economic loss deduction.

The net economic loss carryforward period has been extended to fifteen years effective for tax years beginning on or after January 1, 1999. **There is no corporate NEL carryback deduction available.** (For more information on the net economic loss, see the instructions for Schedule H, Deductions, on Page 8.)

Line 26 - Income Tax

To calculate N.C. income tax, multiply Line 26 by the income tax rate of 6.90%.

Line 27 - Tax Credits

To claim an income tax credit on Line 27, corporations must complete Form CD-425, Corporate Tax Credit Summary, and file it with the tax return. Taxpayers claiming a credit limited by statute to 50% of tax must also complete Form NC-478, Summary of Tax Credits Limited to 50% of Tax, and place it on the front of the completed tax return. Forms for these credits, as well as the CD-425 and NC-478, are available from the Department's website.

The following are some of the more utilized income tax credits for corporations:

- Machinery & Equipment Investment Tax Credit
- Job Creation Tax Credit
- Research and Development Tax Credit
- Worker Training Tax Credit
- Central Office or Aircraft Facility Property Tax Credit
- Business Property Tax Credit
- Investing in Renewable Energy Property Tax Credit
- Credit for Supervisory Fees (savings and loan associations only)
- Credit for the Rehabilitation of Historic Structures
- Credit for Use of North Carolina Ports
- Credit for Real Property Donated for Conservation Purposes

(For specific information regarding each of these credits, refer to the Franchise Tax and Corporate Income Tax Rules and Bulletins.)

Line 29 - Annual Report Fee

Enter the amount of annual report fee due for the tax period on Line 29. *(For detailed information on the annual report fee, see the instructions on Page 4, CD-479, Annual Report.)*

Line 31 - Tax Payments

a. **Application for Extension**. Taxpayers filing a Form CD-419 enter the amount of income tax paid on Form CD-419, Line 5 on Line 31a.
b. **2001 Estimated Tax**. Enter any estimated income tax payments for 2001 (including any portion of the 2000 overpayment that was applied to the 2001 estimated income tax) on Line 31b.
c. **Partnerships** - If the corporation is a nonresident partner, enter the amount of tax paid to North Carolina on behalf of the corporate partner on Line 31c.
d. **Nonresident Withholding** - Enter the amount of tax withheld from a nonresident corporation for nonwage compensation during the taxable year on Line 31d.

Lines 33 and 34 - Income Tax Due / Overpaid

Subtract Line 32 from Line 30. If Line 32 is less than Line 30 **additional income tax is due**. Enter the amount of additional tax on Line 33 and on Line 36. If Line 32 is more than Line 30, **income tax is overpaid**. Enter the amount of overpayment on Line 34 and on Line 36. **Fill in the circle located next to the box on Line 36 to indicate that the amount is an overpayment.**

(Overpaid franchise tax can offset underpaid income tax in the same tax year and vice versa. See Tax Due or Refund section for line-by-line instructions.)

Lines 35 through 41 - Tax Due, Refund, Penalties and Interest

A corporation that overpays its franchise or income tax may elect to have its refund applied to an underpaid franchise or income tax liability in the same tax year. The netting of an overpaid tax to an underpaid liability is calculated by adding or subtracting Lines 35 and 36.

Underpayment of Estimated Income Tax Penalty and Exceptions to the Penalty. A corporation that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a corporation is subject to the penalty if its income tax liability is $500 or more and it did not timely pay the smaller of the corporate income tax liability for 2001 or the prior year's income tax liability.

Use Form CD-429B, Underpayment of Estimated Tax for C Corporations, to see if you owe the penalty. Enter the penalty on Line 38. Do not attach Form CD-429B to the completed tax return, however, maintain this form for future reference.

Penalty Exception:

- Enter an **"S"** in the box labeled Penalty Exception if the corporation's tax year is less than four months, or the requirements to make an estimated payment are not met before the first day of the last month in the short tax year.
- Enter an **"A"** in the box labeled Penalty Exception if the corporation annualized income in determining the penalty.
- Enter an **"R"** in the box labeled Penalty Exception if the corporation elects to add royalties paid to related members pursuant to G.S. 105-130.7A(c). The penalty is not due to the extent the underpayment was created or increased by the royalty payment.
- Enter an **"F"** in the box labeled Penalty Exception if the foreign source dividends deducted by the corporation was reduced by related expenses. The penalty is not due to the extent the underpayment were created or increased by the reduction of the expenses.

Other Penalties and Interest. Interest at the rate established by G. S. 105-241.1 is charged on taxes paid late even if an extension of time to file is granted. The rate is established semiannually by the Secretary and is listed on the Department's website.

Returns filed after the statutory due date or after the approved extended due date will incur a penalty for failure to file of five percent (5%) for each month or fraction of a month delinquent, with a maximum penalty of twenty-five percent (25%) of the tax and a minimum of five dollars ($5.00). Additionally, a penalty of ten percent (10%) will be assessed for failure to timely pay any tax shown due with a return and on other remittances not made within thirty days after being assessed.

Line 40 - Total Due

Add Lines 37, 38, and 39 and enter the total on Line 40, but not less than zero. **This is the total tax, penalties, and interest due**. Mail the return and payment in U.S. currency only for the full amount of tax due to the NCDOR, P.O. Box 25000, Raleigh, NC 27640-0500.

Important: If you owe tax, do not staple, tape, or otherwise attach your check to the completed tax return.

Line 41 - Overpayment

If the total of Line 40 is less than zero, the corporation has overpaid its tax. Enter the amount of overpayment on Line 41.

Line 42 - Estimated Income Tax

A corporation may elect to apply part or all of the overpayment shown on Line 41 to its estimated income tax for the following year by entering the amount to be applied on Line 42. This election cannot be changed after the return is filed.

Line 43 - N.C. Nongame and Endangered Wildlife Fund

Corporations may elect to contribute part or all of their overpayment to the North Carolina Nongame and Endangered Wildlife Fund. Your donations provide most of the funds for conservation of our endangered species and native backyard wildlife. If the corporation wishes to contribute to the fund, enter the amount of the contribution on Line 43.

Line 44 - Amount to be Refunded

Enter the amount of overpayment to be refunded on Line 44. The amount to be refunded cannot exceed Line 41 minus the total of Lines 42 and 43.

Signature and Verification

An authorized officer must sign and date the completed tax form and enter his or her corporate title. If a paid preparer is used, the preparer must also sign and date the return and enter the firm's federal employer ID number, social security number, or PTIN as assigned by the IRS.

Capital Stock, Surplus, and Undivided Profits - Schedule C

In addition to the items listed on the schedule, include stock subscribed, deferred taxes, and all other surplus, reserves, deferred credits, and inventory valuation reserves, including amounts deferred as result of a LIFO valuation method (LIFO reserves), and liabilities except: (a) reserve for depreciation permitted for income tax purposes; (b) accrued taxes; (c) dividends declared; (d) definite and accrued legal liabilities (accounts, notes, mortgages payable, etc.). Deferred income resulting from customer advances for goods or services may be excluded from this base provided: (1) there exists a definite legal liability to render the service or deliver the goods; (2) no part of the advances has been reported or is reportable for income tax purposes; and (3) all related costs and expenses are reflected in the balance sheet as assets. Deferred income net of related deferred income taxes arising from the usual installment sale is not deductible because the corresponding liability would have been discharged at the time of delivery.

Indebtedness owed to a parent, subsidiary, or affiliated corporation is considered a part of the debtor corporation's capital and must be added to the debtor corporation's capital stock, surplus, and undivided profits. If the creditor corporation has borrowed a part of its capital from outside sources (i.e., sources other than a parent, subsidiary, or affiliated corporation), the debtor corporation may exclude a proportionate part of the debt determined on the basis of the ratio of the creditor corporation's capital borrowed from outside sources to the creditor corporation's total assets.

The creditor corporation, if subject to the tax, can deduct from its capital stock, surplus, and undivided profits the amount of indebtedness owed to it by a parent, subsidiary, or affiliated corporation to the extent that the indebtedness has been added by the debtor corporation on a return filed with this State. **The exclusion permitted the debtor corporation and the deduction permitted the creditor corporation are applicable only to indebtedness owed to or due from a parent, subsidiary, or affiliated corporation.**

The term "indebtedness" includes all loans, credits, goods, supplies, or other capital of whatsoever nature furnished by a parent, subsidiary, or affiliated corporation. The terms "parent," "subsidiary," and "affiliate" have the meanings specified in G. S. 105-130.6. The capital stock base may be reduced by the excess of assets of an international banking facility employed outside the United States over liabilities of the corporation owed to foreign persons.

Cash Basis Corporations. Corporations using the cash basis method of accounting for income tax purposes cannot compute the capital stock, surplus, and undivided profits base by this method. Assets and liabilities must be accrued and reported for franchise tax purposes.

Investment in Tangible Property in N.C. - Schedule D

Include all tangible assets located in North Carolina at book value (original purchase price less reserve for depreciation permitted for income tax purposes). In addition to the types of property listed in the schedule, include all other tangible property owned such as supplies and tools. **LIFO valuation is not permitted for inventories.**

A deduction from the tangible property base is allowed for indebtedness incurred and existing by virtue of the purchase or permanent improvement of real estate located in North Carolina. The deductible amount cannot exceed the book value (cost less depreciation) of the real estate acquired or improvements made. Debts incurred in the purchase of personal property are not deductible even though the funds borrowed are secured by a lien against real estate. Indebtedness owed to a parent, subsidiary, or affiliated corporation constitutes a part of the debtor corporation's capital and, therefore, cannot be deducted from the tangible property tax base (except to the extent explained below) even though the indebtedness was incurred in the purchase or permanent improvement of real estate. The extent to which the indebtedness can be deducted is the amount of the total debt excluded by the debtor corporation from its capital stock, surplus, and undivided profits base by application of the creditor corporation's borrowed capital ratio.

Air or Water Pollution Abatement and Recycling Resource Recovering Facilities

A corporation may deduct from Schedule C and Schedule D the cost of any air cleaning device or sewage or waste treatment plant and pollution abatement equipment described in G. S. 105-122(b). The cost of purchasing and installing equipment or constructing facilities for the purpose of recycling or resource recovering of or from solid waste or for the purpose of reducing the volume of hazardous waste generated may also be deducted from these bases. **A deduction is allowed only upon certification from the Department of Environment and Natural Resources.**

Appraised Valuation of Property in N.C. - Schedule E

Enter 55% of the appraised value, not book value, of all property listed for county ad valorem tax in North Carolina. This value includes the appraised value of all vehicles for which the county tax assessor has issued a billing during the income tax year. **Values are to be determined as of the dates specified on Schedule E of the return.**

Other Information - Schedule F

MUST BE COMPLETED BY ALL TAXPAYERS

Federal Taxable Income - Schedule G

Federal taxable income as defined in the Internal Revenue Code, effective as of January 1, 2001, (before net operating loss) is the basis of the computation of North Carolina taxable income. If you attach a copy of your federal income tax return with all supporting schedules, you do not have to complete Schedule G. **A corporation included in a consolidated filing for federal income tax purposes must attach a copy of its separate federal taxable income.**

Adjustments to Federal Taxable Income - Schedule H

Taxpayers must make certain adjustments to federal taxable income in arriving at North Carolina net income. Schedule H provides some of the differences required by statute but is not an all-inclusive list. Following is a detailed listing of State adjustments to federal taxable income.

Additions to Federal Taxable Income

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

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

(2) Interest paid in connection with income exempt from State income tax.

(3) Contributions deducted on the federal return.

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

(5) The amount by which gains have been offset by the capital loss carry-over allowed under the Internal Revenue Code. (All gains recognized on the disposition of assets must be included in determining State net income or loss in the year of disposition.)

(6) Net operating loss deducted on the Federal return.

(7) Payments to or charges by a parent, subsidiary, or affiliated corporation in excess of fair compensation in all intercompany transactions.

(8) The amount of tax credits allowed against N.C. income tax. **In lieu of the addback of tax credits to federal taxable income, taxpayers must reduce the amount of credit available by the current income tax rate.** (See Form CD-425, Part 4, Line 26.)

(9) The amount of percentage depletion in excess of cost depletion applicable to mines, oil and gas wells, and other natural deposits located outside this State.

(10) The amount allowed under the Code for depreciation for a utility plant acquired by a natural gas local distribution company.

(11) The amount of income the Code allowed the taxpayer to exclude because the income was attributed under Internal Revenue Code Section 925 to a FSC.

(12) The amount of royalty payments required to be added by G.S. 105-130.7A, to the extent deducted in calculating federal taxable income.

Deductions from Federal Taxable Income

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

(1) Interest income from obligations of the United States or its possessions net of direct or indirect expense related to the income.

(2) Payments received from an affiliated corporation not deductible by the corporation under N.C. law.

(3) Net economic losses incurred by the corporation. There is no corporate NEL carryback deduction available. The net economic loss carryforward period is extended to fifteen (15) years effective for tax years beginning on or after January 1, 1999. A loss that is more than five years old may not offset more than 15% of taxable income. A net economic loss is the amount by which allowable deductions, other than prior year losses, exceed income from all sources in the year including any nontaxable income. Nontaxable income includes income deducted from federal taxable income in computing State net income, nonbusiness income allocated outside this State, and other income not taxable under State law. Any nontaxable income received in a succeeding year must be deducted from the loss brought forward in arriving at the allowable net economic loss deduction.

(4) Contributions to the extent provided under G.S. 105-130.9.

(5) Amortization in lieu of depreciation allowed for Federal income tax purposes on the cost of qualified sewage, waste or air pollution facilities, recycling and resource recovering facilities, equipment mandated by OSHA, and equipment and facilities acquired for the purpose of reducing the volume of hazardous waste generated as provided in G.S. 105-130.10 and G.S. 105-130.10A.

(6) Depreciation of emergency facilities acquired prior to January 1, 1955, if no amortization has been claimed on the facilities for State income tax purposes.

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

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

(9) The amount by which an ordinary and necessary business expense has been reduced on the Federal income tax return because a tax credit was claimed in lieu of the deduction on that return.

(10) Reasonable expenses paid for reforestation and cultivation of commercially grown trees by a corporation owned entirely by natural persons actively engaged in the commercial growing of trees.

(11) The amount of eligible income of an international banking facility to the extent included in determining federal taxable income.

(12) The amount by which the tax basis of certain property is reduced as the result of compliance with federal investment tax credit provisions.

(13) Marketing assessments paid on tobacco grown in N.C.

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

(15) Interest, net of related expenses, received from N.C. obligations included in federal taxable income.

(16) Wireless enhanced 911 service charges collected under G.S. 62B-3 and remitted to the Wireless Fund under G.S. 62B-4.

(17) Any interest, investment earnings, and gains of a Trust established by two or more manufacturers that signed a settlement agreement with N.C. to settle claims for damages attributable to a product of the manufacturers.

(18) Amounts paid to taxpayer from the Hurricane Floyd Reserve Fund in the Office of State Budget, Planning, and Management.

(19) The amount of royalty payment received from a related member who added the payments to income under G.S. 105-130.7A for the same taxable year.

(20) The amount of dividends received from sources outside the United States as determined under section 862 of the Code, to the extent included in federal taxable income.

(21) Any amount included in federal taxable income under section 78 or section 951 of the Code.

Other Adjustments to Federal Taxable Income

The following other adjustments to Federal taxable income must be made in determining State net income:

(1) No deduction is allowed for annual amortization of bond premiums applicable to any bond acquired prior to January 1, 1963. The amount of premium paid on any such bond is deductible only in the year of sale or other disposition.

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

(3) Deductions are generally not allowed for any direct or indirect expenses related to income not taxed.

(4) Federal taxable income must be increased or decreased to account for the recovery of previously deducted amounts that differ for state income tax purposes.

(5) Interest on deposits with the FHLB (savings and loan associations only).

Depreciation Recapture. Any recapture of depreciation required under the Internal Revenue Code must be included in a corporation's State net income to the extent required by Federal law.

Schedule K

Due to form redesign, the letter K is not used on the tax return to designate a schedule.

Balance Sheet - Schedule L

Complete this schedule only if you do not attach a copy of federal 1120, Schedule L, along with all supporting schedules.

Reconciliation of Income (Loss) - Schedule M-1

Analysis of Unappropriated Retained Earnings - Schedule M-2

Complete these schedules only if you do not attach a copy of federal 1120, Schedules M-1 and M-2, along with all supporting schedules.

Schedule N - Nonbusiness Income

Rents and royalties from real or tangible personal property, gains and losses, interest, dividends, patent and copyright royalties, and other kinds of income, if these income items are nonbusiness income, less related expenses are required to be allocated. (A detailed explanation of nonbusiness income is contained in the Franchise Tax and Corporate Income Tax Rules and Bulletins.)

Rents and Royalties from Real and Tangible Property. Net rents and royalties from **real property** located in this State are allocable to this State. Net rents and royalties from **tangible personal property** are allocable to this State:

(1) if and to the extent that the property is utilized in this State, or
(2) in their entirety if the corporation's commercial domicile is in this State and the corporation is not organized under the laws of, or is not taxable in, the state in which the property is utilized.

The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the income year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the income year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the corporation, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

Gains or Losses on Disposition of Property. Gains and losses from sales or other dispositions of **real property** located in this State are allocable to this State. Gains and losses from sales or other dispositions of **tangible personal property** are allocable to this State if:

(1) the property had a situs in this State at the time of the sale, or
(2) the corporation's commercial domicile is in this State and the corporation is not taxable in the state in which the property had a situs.

Gains and losses from sales or other dispositions of **intangible personal property** are allocable to this State if the corporation's commercial domicile is in this State.

Interest and Dividend Income. Interest income and dividend income, net of any dividends deducted in computing State net income or loss pursuant to G.S. 105-130.7, are allocable to this State if the corporation's commercial domicile is in this State.

Royalties and Similar Income from Intangible Property. Royalties or similar income received from the use of patents, copyrights, secret processes, and other similar intangible property are allocable to this State:

(1) if and to the extent that the patent, copyright, secret process, or other similar intangible property is utilized in this State, or
(2) if and to the extent that the patent, copyright, secret process, or other similar intangible property is utilized in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

A patent, secret process, or other similar intangible property is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, processing, or other use in the state or to the extent that a patented product is produced in the state. If the basis of receipts from this intangible property does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the intangible property is utilized in the state in which the taxpayer's commercial domicile is located.

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

Other Nonbusiness Income. The income less related expenses from any other nonbusiness activities or investments is allocable to this State if the business situs of the activities or investments is located in this State.

Computation of Apportionment Factor - Schedule O

All corporations, domestic or foreign, doing business in North Carolina must complete Schedule O in order to compute North Carolina taxable income.

Domestic Corporations - Part 1

Domestic corporations and other corporations not apportioning franchise or income outside of N.C. must enter 100% in the area provided. Domestic corporations are those corporations or associations created or organized under the statutory laws of N.C. Foreign corporations doing business in N.C. but not taxable in another state must also enter 100% for its apportionment factor.

Multistate Corporations - Part 2

A corporation having "business income" from business activity that is taxable both within and without N.C. is required to apportion its State net income or net loss. For purposes of allocation and apportionment, a corporation is taxable in another state if (i) the corporation's business activity in that state subjects it to a net income tax or a tax measured by net income, or (ii) that state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless of whether that state exercises its jurisdiction. For purposes of this section, 'business activity' includes any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code § 381.

All business income of corporations other than public utilities and excluded corporations must be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. If the sales factor does not exist, the denominator is the number of existing factors. If a property or a payroll factor does not exist, the denominator is the number of existing factors plus one. **Calculate the apportionment factor to four places to the right of the decimal.**

Lines 1 through 8 - Property Factor

The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this State during the income year and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the income year. The numerator includes not only inventories actually located in North Carolina but also inventories in transit with a North Carolina destination.

Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net rent paid during the current income year. Net annual rent is the annual rent paid by the corporation less any annual rent received by the corporation from subrentals except that subrentals are not deductible when they constitute business income. Any property under construction or any property not actually used or operated in the corporation's business during the income year and any property the income from which constitutes nonbusiness income are excluded in the computation of the property factor.

The average value of property is determined by averaging the values at the beginning and end of the income year, but in all cases the Secretary may require the averaging of monthly or other periodic values during the income year if required to reflect properly the average value of the corporation's property. A corporation that ceases its operation in this State before the end of its income year for any reason whatsoever must use property values as of the first day of the income year and the last day of its operations in this State in determining the average value of property; however, the Secretary may require the averaging of monthly or other periodic values during the income year.

Lines 9 through 11 - Payroll Factor

The payroll factor is a fraction, the numerator of which is the total compensation paid in this State during the income year by the corporation and the denominator of which is the total compensation paid everywhere during the income year. All compensation paid to general executive officers and all compensation paid in connection with nonbusiness income shall be excluded in computing the payroll factor. General executive officers include the chairman of the board, president, vice-presidents, secretary, treasurer, comptroller, and any other officer serving in similar capacities.

Compensation is paid in this State if any of the following applies:

(1) The individual's service is performed entirely within the State; or
(2) The individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State.
(3) Some of the service is performed in this State and the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled, is in this State.
(4) Some of the service is performed in this State and the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

Lines 12 and 13 - Sales Factor

The sales factor is a fraction, the numerator of which is the total sales of the corporation in this State during the income year, and the denominator of which is the total sales of the corporation everywhere during the income year. Receipts from any casual sale of property, receipts exempt from taxation, and the portion of receipts realized from the sale or maturity of securities or other obligations that represent a return of principal are excluded from both the numerator and the denominator of the sales factor. If a corporation is not taxable in another state on its business income but is taxable in another state only because of nonbusiness income, all sales are treated as having been made in this State.

Sales of tangible personal property are in this State if the property is received in this State by the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed is considered the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State constitutes delivery to the purchaser in this State.

Other sales are in this State if any of the following applies:

(1) The receipts are from real or tangible personal property located in this State.
(2) The receipts are from intangible property and are received from sources within this State.
(3) The receipts are from services and the income-producing activities are in this State.

Excluded Corporations and Public Utilities - Part 3

Special apportionment provisions apply to the business income of public utility corporations and excluded corporations. The respective tax statutes should be consulted for specific allocation requirements.

Excluded Corporation. Any corporation engaged in business as a building or construction contractor, a securities dealer, a loan company, or a corporation that receives more than fifty percent (50%) of its ordinary gross income from intangible property apportions its business income by using one sales factor only.

Contractors. A multistate building or construction contractor must use a one factor sales (gross receipts) formula to apportion its business income to this State. A building or construction contractor is a business so classified under the North American Industry Classification System.

Air and Water Transportation. All business income of an air or water transportation company is apportioned by the ratio of revenue-ton miles in North Carolina to total revenue-ton miles. A revenue-ton mile is one ton of passenger, freight, mail, or other cargo carried one mile; each passenger is deemed to weigh 200 pounds.

Telephone Companies and Motor Carriers - Part 4

Telephone Companies. All business income of a telephone company must be apportioned by multiplying the income by a fraction, the numerator of which is gross operating revenues earned in this State plus other revenue items attributed to this State specifically listed in G.S. 105-130.4(n) and the denominator of which is the total gross operating revenue from all business done by the company everywhere less uncollectible revenue.

Motor Carriers. All business income of a motor carrier of property or passengers must be apportioned by multiplying the income by a fraction, the numerator of which is the number of vehicle miles in this State and the denominator of which is the total number of vehicle miles of the company everywhere. The words "vehicle miles" mean miles traveled by vehicles owned or operated by the company hauling property for a charge, carrying passengers for a fare, or traveling on a scheduled route.

Telephone companies and motor carriers complete the following worksheet and enter the factor computed on Schedule O, Part 4.

Computation of Apportionment Factor for Telephone Companies and Motor Carriers

A. Vehicle Miles Factor ***(For corporations whose business is the operation of a motor carrier of property or passengers)***

1. Number of vehicle miles traveled in N.C. .... ______________

2. Total number of vehicle miles traveled everywhere .... ______________

3. Percentage of Mileage to N.C. Factor *(Divide Line 1 by Line 2; enter amount here and on Schedule O, Part 4)* .... ___.____%

B. Gross Operating Revenue Factor ***(For corporations whose income is derived from the operation of a telephone company)***

1. Gross Operating Revenues in North Carolina

a. Gross operating revenue from local service in N.C. .... ______________

b. Gross operating revenue from toll services within N.C. .... ______________

c. N.C. portion of revenue from interstate toll services .... ______________

d. Gross operating revenues in N.C. from other services .... ______________

e. Total gross operating revenues assignable to N.C. *(Add Lines 1a - 1d)* .... ______________

f. N.C. uncollectible revenue .... (______________)

g. Total adjusted gross operating revenues assignable to N.C. *(Line 1e minus Line 1f)* .... ______________

2. Gross Operating Revenues Everywhere

a. Total gross operating revenues .... ______________

b. Total uncollectible revenue .... ______________

c. Total adjusted gross revenues everywhere *(Line 2a minus 2b)* .... (______________)

3. Gross Operating Revenue Factor *(Divide Line 1g by Line 2c; enter amount here and on Schedule O, Part 4)* .... ___.____%

Instructions and Forms for the NC-478 Series

NC-478, NC-478A-H, and NC-478 Instructions are available at the Department's website, www.dor.state.nc.us, or by calling (919) 715-0397.