

State of North Carolina

FRANCHISE TAX  
CORPORATE INCOME TAX  
PRIVILEGE TAX  
INSURANCE PREMIUM TAX  
EXCISE TAX

RULES AND BULLETINS  
TAXABLE YEARS  
2007 & 2008

Issued By

Corporate, Excise and Insurance Tax Division  
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## **PREFACE**

This publication represents the administrative interpretation and application of the North Carolina corporate income, franchise, excise, privilege and insurance premium tax laws. It covers the major provisions of these tax laws but may not cover all of their provisions. Illustrative examples are included for some subjects.

Information in this publication is intended as a guide to the taxpayer for the taxable years 2007 and 2008 and consideration must be given to all the facts and circumstances in applying these bulletins to particular situations. The taxpayer should be alert for changes which may result from legislative action, court decisions, Attorney General opinions or from rules adopted or amended under the Administrative Procedures Act, Chapter 150B of the General Statutes.

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# **I. FRANCHISE TAX**

## **(Article 3)**

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

#### **1. Scope and Nature**

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

G.S. 105-114.1	Limited liability companies
G.S. 105-116	Electric power, water, and sewerage companies
G.S. 105-120.2	Holding companies
G.S. 105-121.1	Mutual burial associations
G.S. 105-122	General business corporations
G.S. 105-125	Exempt corporations

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

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

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

#### **2. Corporation Defined**

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

#### **3. S Corporations**

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

#### **4. Period Covered**

Taxes levied under this Subchapter are for the fiscal year of the State in which they become due, except for the general business franchise tax that is for the income year of the corporation in which such taxes become due.

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

A corporation that is inactive and without assets is subject annually to a minimum franchise tax of thirty-five dollars (\$35). 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.

#### **6. Dissolution or Withdrawal of Corporate Rights (17 NCAC 05B.0105)**

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. Therefore, no franchise tax is required with the income tax return filed for the year in which the application is filed or with any subsequent income tax returns that may be required in connection with winding up the affairs of the corporation.

Example 1: A calendar year corporation files articles of dissolution or withdrawal during the calendar year 2007. Although its final income tax return will be filed on a combined franchise and income tax form, the franchise tax portion of the return need not be completed since the franchise tax applicable to calendar year 2007 was due on March 15, 2007 with the combined 2006 return.

Example 2: A corporation using an income year ending April 30 files articles of dissolution or withdrawal on May 19, 2007. Although its final income tax return will be filed on a combined franchise and income tax form, the franchise tax portion of the final return need not be completed since the franchise tax applicable to the income year beginning May 1, 2007 was due on July 15, 2007 with the combined tax return for the income year ended April 30, 2007. A corporation is not entitled to a partial refund of its franchise tax paid if it files articles of dissolution or withdrawal during the year.

#### **7. Payment of Franchise Taxes**

General business corporation franchise and income taxes are due on the statutory filing date of the return, without regard to any extensions.

The utility franchise tax, dependent on various law requirements, may be due monthly or quarterly as stated under the paragraph of "Due Date of the Return and Tax" of each utility tax type. All utility companies, except electric power companies, with an average franchise utility tax of twenty thousand dollars (\$20,000) or more per month are required to remit the utility tax by Electronic Funds Transfer. An electric power company is required to pay franchise utility tax by EFT if the company is required to prepay its tax.

For additional information on EFT, refer to the subject: “Payments of Taxes by Electronic Funds Transfer (EFT)”, in the General Administration section.

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

Prior to the regular due date, a corporation may apply for an extension of time for filing its return.

For additional detailed information concerning the requirements for obtaining an extension of time for filing a corporate franchise and income tax return, see the subject, “Extension of Time for Filing Return”, in the Corporate Income Tax section.

**9. Tax Credit for Limited Liability Companies Subject to Franchise Tax**

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

**B. Electric Power, Water, and Sewerage Companies (G.S. 105-116)**

**1. Basis for Taxation**

Every person, firm or corporation, domestic or foreign, and jointly owned and operated municipal electric projects established under Chapter 159B, engaged in the business of furnishing electricity, electric lights, current or power are subject to a franchise or privilege tax at the rate of three and twenty-two hundredths percent (3.22%) of the total gross receipts derived from such business within this state, less certain statutory deductions. Public sewerage companies are subject to a six percent (6%) franchise or privilege tax on total revenues derived from within this state. Water systems are subject to a four percent (4%) franchise or privilege tax on total revenues derived from within this state. Receipts received as contributions in aid of construction are not subject to tax.

Companies subject to the three and twenty-two hundredths percent (3.22%) franchise tax and municipal corporations purchasing power for resale are required to collect and remit to the state a sales tax at the rate of three percent (3%) of total billings. Any excess sales tax collected by the vendor is to be remitted to the state.

Electric power companies are not subject to any additional franchise or privilege tax imposed upon it by any city or county as long as the company remits the State franchise tax to the Secretary.

**2. Due Date of the Return and Tax**

The returns are due quarterly and should contain, in addition to the other information, the total gross receipts on an accrual basis from such business in North Carolina for the preceding calendar quarter. The return is due by the last day of the month that follows the quarter covered by the return. Payments are due as follows:

**a. Electric Power Companies**

An electric power company that is consistently liable for less than one hundred dollars (\$100) per month in franchise tax is required to pay its tax on a quarterly basis. The tax is due at the same time the quarterly return is due.

An electric power company that is consistently liable for at least one hundred dollars (\$100) per month in franchise tax is required to pay its tax on a monthly basis. The tax is due by the 20<sup>th</sup> day of the month following the calendar month for which the payment applies.

Additionally, if an electric power company's liability is consistently at least ten thousand dollars (\$10,000) per month, the electric power company must prepay the next month's tax liability at the same time that it is paying the current month's liability. The prepayment must equal at least sixty-five percent (65%) of any of the following:

- The amount of tax due for the current month.
- The amount of tax due for the same month in the preceding year.
- The average monthly amount of tax due in the preceding calendar year.

An electric power company that is required to prepay its tax must pay by electronic means.

**b. Water & Sewerage Companies**

Companies pay tax quarterly when filing the quarterly return, which is due by the last day of the month that follows the quarter covered by the report.

**3. Forms to be Used for Filing**

Form CD-310 is to be used by electric power companies. Form CD-318 is to be used by water and sewerage companies.

**4. Special Exemption**

Municipal corporations are not required to remit a franchise or privilege tax directly to the State, but are required to file returns and remit the utility sales tax of three percent (3%). The total receipts of the vendor subject to franchise tax include sales made to a municipal corporation.

**5. Distribution to Municipalities**

An amount equal to a tax of three and nine hundredths percent (3.09%) of local service revenues subject to the franchise tax levied by this Section on electric power companies derived from within a legally incorporated municipality having either elected officials or interim officials appointed by the Legislature and from within Urban Service Districts as defined by the governing board in Chapter 160B, Article 2 is distributed to such municipality within seventy-five (75) days after the end of the calendar quarter.

## **C. Holding Companies (G.S. 105-120.2)**

### **1. Definition**

A holding company is any corporation that receives more than eighty percent (80%) of its gross income during its taxable year from corporations in which it owns, directly or indirectly, more than fifty percent (50%) of the outstanding voting stock or voting capital interest.

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

### **2. Basis for Taxation**

The basis of the tax is the same as for general business corporations. However, franchise tax payable by a qualified holding company on its capital stock and surplus tax base shall be limited to an amount not exceeding seventy-five thousand dollars (\$75,000). Any corporation that qualifies as a holding company for franchise tax should fill in the circle next to Line 1 on Page 1 of the appropriate form, CD-405 or CD-401S. There is no limitation on the amount of franchise tax payable where the alternative tax bases of investment in tangible property or appraised value of property apply.

## **D. Mutual Burial Associations (G.S. 105-121.1)**

### **1. Basis for Taxation**

All domestic mutual burial associations are subject to an annual franchise or privilege tax ranging from fifteen dollars (\$15) to fifty dollars (\$50). The amount of tax is based on the number of members.

### **2. Due Date of the Tax**

The tax is due on or before April 1 of each year.

### **3. Association Billed For the Tax**

There is no form to be completed by the association for the computation of this tax. The association will be billed by the Department of Revenue in early March of each year.

## **E. General Business Corporations (G.S. 105-122)**

### **1. Basis For the Tax**

The basis of the tax is total or allocated capital stock, surplus and undivided profits. The basis is the same for both domestic and foreign corporations. Corporations doing business both within and without North Carolina are required to allocate a part of their capital stock, surplus and undivided profits to their business in North Carolina in accordance with a specified statutory allocation formula. Regardless of the actual amount of capital stock, surplus and undivided profits, the amount determined for purposes of this tax cannot be less than fifty-five percent (55%) of appraised ad

valorem tax value of all tangible property plus value of intangible property in North Carolina nor less than the actual investment in tangible property in North Carolina.

## **2. Franchise Tax Bases**

The taxable franchise tax base is the largest of these tax bases:

- Capital stock, surplus and undivided profits
- Fifty-five percent (55%) of appraised ad valorem tax value of all tangible property in N. C.
- Actual investment in tangible property in North Carolina

## **3. Corporations Required to File**

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

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

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

## **4. No Double Taxation (G.S. 105-114(a4))**

A corporation, other than a holding company taxed under G.S. 105-120.2, that is subject to one of the franchise taxes other than the general business franchise tax is subject to the general business franchise tax to the extent it exceeds the other franchise tax. This provision preventing double taxation also applies to a corporation if a limited liability company whose assets must be included in the corporation's tax base under G.S. 105-114.1 is subject to one of the other franchise taxes.

## **5. Forms to be Used for Filing**

The general business franchise tax is filed on Form CD-405 for both domestic and multistate C corporations and Form CD-401S for S corporations. These forms, along with other required corporate forms and instructions, are available from the Department of Revenue in Raleigh or from any of the branch offices located throughout the State. The forms and other related schedules are also available from the Department's web site at [www.dornc.com](http://www.dornc.com).

**6. Substitute Returns**

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

**7. Report and Payment Due**

General business corporations must file returns annually on or before the fifteenth day of the third month following the end of the income year. Effective for taxable years beginning on or after January 1, 2008, the return will be due on the fifteenth day of the fourth month. The return is filed as a part of a combined franchise and income tax return. Payment of the entire amount of franchise tax is required by the statutory due date of the return.

**8. Tax Rate**

The franchise tax rate is one dollar and fifty cents (\$1.50) per one thousand dollars (\$1,000) and is applied to the largest of the three bases determined as set forth in the law. The minimum franchise tax is thirty-five dollars (\$35).

**9. Franchise Tax Payable in Advance (G.S. 105-114)**

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

Example: A corporation incorporates, domesticates or commences business in North Carolina on October 15, 2006. The corporation has selected the calendar year as its income year end. The first tax return due on March 15, 2007 will be a short period return covering the income tax period from October 15, 2006 to December 31, 2006. Franchise tax due on this return covers the ensuing calendar year through December 31, 2007 for the privilege of doing business in North Carolina or for the privilege of existing as a corporation in North Carolina.

**F. Capital Stock, Surplus and Undivided Profits Base (G.S. 105-122(b) & (c))**

**1. Based on the Year End Balance Sheet**

This base is determined from the corporation's books and records, as reflected by its balance sheet, used for financial accounting purposes, as of the close of the income year immediately preceding the due date of the return.

**2. Surplus Defined**

The term "surplus" for franchise tax purposes has a broader and more inclusive meaning than the generally accepted accounting definition. It includes, in addition to the balance sheet surplus, all liabilities, reserves and deferred credits.

### **3. Items Includable and Excludable**

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

The following items are excludable from capital stock, surplus and undivided profits in arriving at the net base:

- a. Cost of treasury stock.
- b. Definite and accrued legal liabilities.
- c. Accrued taxes.
- d. Reserve for depreciation permitted for income tax purposes.
- e. Dividends declared.
- f. Reserves for cost of any air-cleaning device or sewage or waste treatment plant, including waste lagoons, and pollution abatement equipment certified by the Department of Environment and Natural Resources or the Environmental Management Commission. Reserves for cost should be net of any depreciation on the equipment excluded from the base.
- g. Cost of purchasing and installing equipment or constructing facilities for the purpose of recycling or resource recovering of or from solid waste certified by the Department of Environment and Natural Resources. Cost should be net of any depreciation on the equipment and facilities excluded from the base.
- h. Cost of constructing facilities of any private or public utility built for the purpose of providing sewer service to residential and outlying areas. Cost should be net of any depreciation on the facility excluded from the base.
- i. Cost of equipment and facilities acquired for the purpose of reducing the volume of hazardous waste generated. Cost should be net of any depreciation on the equipment and facilities excluded from the base.

- j. A “Regulated Investment Company” or “Real Estate Investment Trust” is allowed to exclude the aggregate market value of its investments in stocks, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies, or governments.
- k. All assets of an international banking facility which are employed outside the United States less all liabilities owed to foreign persons by the facility.
- l. The corporation’s investment in an LLC if the corporation is required to include a percentage of the LLC’s income, assets, liabilities, and equity in the corporation’s franchise tax calculation under G.S. 105-114.1.

The following items are includable:

- a. Capital stock subscribed
- b. Appraisal surplus.
- c. Reserve for bad debts.
- d. Deferred income (except as explained above).
- e. Deferred tax liabilities (may be reduced by deferred tax assets, but not below zero. No other deferred liabilities may be reduced by deferred tax assets).
- f. Contingent liabilities.
- g. Inventory valuation reserves.
- h. LIFO “reserves.”
- i. Any other reserves that are not definite and accrued legal liabilities. To be definite and accrued, the liability must be definite in amount and must be incurred prior to the end of the taxable year. To be definite in amount, the liability must be exactly determined, and not merely accurately estimated.

For example: The “billings in excess of cost” account determined under the percentage of completion method is based on estimates and therefore is not a definite and accrued legal liability. The “billings in excess of cost” liability account may not be reduced by the “costs in excess of billings” asset account. That account will consist of different contracts than the ones included in the “billings in excess of cost” account.

- j. Percentage of LLC income, assets, liabilities, and equity under G.S. 105-114.1. For additional information on the filing requirements for members of LLCs,

see Subsection J “Corporate Members of LLCs” and Item 5, Subsection L “Corporations Conditionally or Partially Exempt.”

**4. Exclusion of Retained Earnings by Parent Corporation (17 NCAC 05B.1104)**

A parent corporation may exclude any retained earnings of existing subsidiary corporations that it has capitalized or otherwise recorded on its books, through an equity method of accounting.

**5. Investment in Subsidiary (17 NCAC 05B.1105)**

No reduction of the capital stock base is allowed for the investment in a subsidiary except as provided in G. S. 105-114.1(d).

**6. Borrowed Capital Treatment (Debtor Corporation)**

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 tax base.

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 in computing the amount to be added determined on the basis of the ratio of the creditor corporation’s capital borrowed from outside sources to the creditor corporation’s total assets.

Example: ABC Corporation owes two hundred thousand dollars (\$200,000) to its parent XYZ Corporation. XYZ’s capital borrowed from outside sources is seventy-five thousand dollars (\$75,000) and its assets total three hundred thousand dollars (\$300,000).

Indebtedness owed to XYZ Corporation	\$200,000
Less proportionate part:	
<u>XYZ’s borrowed capital</u>	<u>\$ 75,000</u>
XYZ’s total assets	\$300,000
	x \$200,000 =
	<u>50,000</u>
Net amount to be added by ABC Corporation	\$150,000

XYZ Corporation is entitled to deduct one hundred fifty thousand dollars (\$150,000), the net amount added by ABC Corporation, from its capital stock, surplus and undivided profits.

**7. Borrowed Capital Treatment (Creditor Corporation)**

The creditor corporation, if subject to the tax, can deduct the amount of indebtedness owed to it by a parent, subsidiary or affiliated corporation to the extent that such indebtedness has been added by the debtor organization. If the corporations have different income years, the creditor corporation shall deduct the amount of indebtedness added back by the parent, subsidiary, or affiliate on the return immediately preceding that of the creditor.

**8. Exclusion Provision Limited to Indebtedness Owed (17 NCAC 05B.1108)**

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. These provisions do not apply where the indebtedness is merely endorsed or guaranteed.

**9. Equity Capital Not Deductible (17 NCAC 05B.1109)**

The equity capital of a wholly owned subsidiary does not represent “indebtedness” owed to a parent corporation which the parent is entitled to deduct from its franchise tax base.

**10. Reciprocal Indebtedness Between Affiliates (17 NCAC 05B.1110)**

A corporation which owes indebtedness to a parent, subsidiary or affiliated corporation and at the same time is owed indebtedness by the same parent, subsidiary or affiliated corporation may net the payable and receivable for purposes of the indebtedness computation. If the indebtedness is owed to one corporation and the receivable is due from another corporation, each amount must be treated separately.

**11. Indebtedness Defined**

The term “indebtedness” as used under G.S. 105-122(b) includes all loans, credits, goods, supplies or other capital of whatever nature furnished by a parent, subsidiary or affiliated corporation. The terms “parent,” “subsidiary” and “affiliate” have the meanings specified in subsection N.5 of the Corporate Income Tax section of this bulletin.

**12. Borrowed Capital Defined**

The term “borrowed capital” as used under G.S. 105-122(b) includes all loans, credits, goods, supplies, or other capital of whatsoever nature furnished by a source other than a parent, subsidiary or affiliated corporation.

**13. Creditor Corporation Defined**

The creditor corporation is considered to be the parent, subsidiary, or affiliated corporation to which the indebtedness is directly owed.

**14. Cash Basis Corporations (17 NCAC 05B.1115)**

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

**G. Multistate Corporations (G.S. 105-122(c))**

**1. Apportionment Formula**

Every corporation permitted to apportion its net income for income tax purposes under the provisions of G.S. 105-130.4 must apportion its capital stock, surplus and undivided profits for franchise tax purposes through use of the same fraction computed for apportionment of its apportionable income under G.S. 105-130.4. A corporation

that is subject to the general business franchise tax, but exempt from income tax, must apportion its capital stock, surplus and undivided profits by using the apportionment factor it would have used had it been subject to the income tax. Adjustments in the method of apportionment authorized by the Secretary of Revenue for apportionment of net income do not apply automatically to apportionment of capital stock, surplus and undivided profits. Unless the Secretary specifically authorizes a modified method of allocation for franchise tax purposes, the statutory formula must be used.

## **2. Alternate Apportionment Formula**

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

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

If the request for an alternative method of apportionment is granted, the order can apply to no more than three years. If the request is denied, the Secretary's decision is final and is not subject to administrative or judicial review. A corporation authorized to use an alternative formula may apportion its capital stock base using the alternative method or the statutory method.

## **H. Investment in Tangible Properties in North Carolina Base (G.S. 105-122(d))**

### **1. Basis For the Investment Base**

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

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

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

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

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

#### 4. Indebtedness Deduction

A deduction from the tangible property base is allowed for existing indebtedness incurred in the purchase or permanent improvement of real estate. The deductible amount cannot exceed the book value (cost less depreciation) of the real estate acquired or improvements made. Indebtedness incurred in the purchase of personal property is not deductible even though the funds borrowed may have been 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 such indebtedness was incurred in the purchase or permanent improvement of real estate. The extent to which such indebtedness can be deducted is the amount of the total debt excluded by the debtor corporation from its capital stock, surplus and undivided profits tax base by application of the creditor corporation's borrowed capital ratio.

Example: ABC Corporation owes its parent, XYZ Corporation, three hundred thousand dollars (\$300,000), which it borrowed for the purchase of real estate. XYZ's borrowed capital from non-affiliated sources is five hundred thousand dollars (\$500,000) and its assets total seven hundred fifty thousand dollars (\$750,000). Assuming ABC Corporation owns no other tangible property, its tangible property base would be computed as follows:

Investment in real estate					\$300,000
Deductible indebtedness:					
<u>XYZ's borrowed capital</u>	<u>\$500,000</u>				
XYZ'S total assets	\$750,000	x	\$300,000	=	<u>\$200,000</u>
Net tangible property base					\$100,000

When real estate and personal property are acquired at a lump sum price and the specific amount of indebtedness applicable to each type of property cannot be determined, the deductible amount is the proportion of the total amount that the cost assigned to the real estate bears to the total cost of the properties.

Example: ABC Corporation, which operates on a calendar-year basis, purchased an entire plant for one million dollars (\$1,000,000), paying one hundred thousand dollars (\$100,000) down and giving a mortgage for the balance. Costs were allocated to specific assets as follows:

Land	\$	50,000
Building		300,000
Machinery and other personal property		<u>650,000</u>
Total purchase price		\$1,000,000

As of December 31, 2006 the balance owed on the mortgage was eight hundred fifty thousand dollars (\$850,000). The amount of indebtedness deductible from total investment in tangible properties on the return due on March 15, 2007 would be computed as follows:

$$\frac{\text{Total cost of land and building } \$ 350,000}{\text{Total cost of plant } \$1,000,000} \times \$850,000 = \$297,500$$

No interest accrued on the mortgage would be deductible or used in the computation.

#### **5. Refinancing of a Loan (17 NCAC 05B.1306)**

When an existing loan incurred in the purchase or improvement of real estate is refinanced and additional funds are secured and spent for purposes other than the purchase or improvement of real estate, the deductible portion of the new loan is determined on the basis of the unpaid balance of the old loan to the total of the new loan.

Example: A corporation operating on a March 31 fiscal year purchased land and a building several years ago and incurred a mortgage of fifty thousand dollars (\$50,000). The balance of this mortgage at December 31, 2006 was thirty thousand dollars (\$30,000). At that time the mortgage was refinanced and the new loan was forty thousand dollars (\$40,000). The additional ten thousand dollars (\$10,000) was used to buy machinery and for working capital. At March 31, 2007 (end of fiscal year), the mortgage was thirty-nine thousand dollars (\$39,000).

$$\frac{\text{Unpaid balance of original loan } \$30,000}{\text{Total balance of new loan } \$40,000} \times \$39,000 = \$29,250$$

#### **6. Pollution Abatement Facilities**

A deduction from the tangible property base is provided for the cost of any air-cleaning device, or sewage or waste treatment plant, including waste lagoons, and pollution abatement equipment certified by the Department of Environment and Natural Resources or the Environmental Management Commission. Cost should be net of any depreciation on the equipment excluded from the base.

#### **7. Qualifying Recycling, Sewer Service, and Hazardous Waste Facilities**

A deduction from the tangible property base is provided for the cost of installing equipment or constructing facilities for the purpose of recycling or resource recovering of or from solid waste certified by the Department of Environment and Natural Resources.

Deductions are also provided for the cost of constructing facilities of any private or public utility built for the purpose of providing sewer service to residential and outlying areas and the cost of equipment and facilities acquired for the purpose of reducing the volume of hazardous waste generated.

For purposes of this section, cost should be net of any depreciation on the equipment or facilities excluded from the tangible property base.

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

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

**9. Holding Company**

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

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

**1. Basis For Tangible Property**

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

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

**2. Holding Company**

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

**J. Corporate Members of LLCs (G.S. 105-114.1)**

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

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

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

When a partnership, trust, LLC, or other entity is placed between a corporation and an LLC, ownership of the capital interests in an LLC is determined under the constructive

ownership rules for partnerships, estates, and trusts in IRC §318(a)(2)(A) and (B), modified as follows:

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

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

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

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

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

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

Example: An affiliated group of corporations own one hundred percent (100%) of the capital interests in an LLC. The group consists of three corporations. Corporation

A is doing business in North Carolina and owns fifty percent (50%) of the LLC. Corporation B is doing business in North Carolina and owns ten percent (10%) of the LLC. Corporation C is not doing business in North Carolina and owns forty percent (40%) of the LLC. The percentage of the LLC's assets required to be included in Corporation A's and Corporation B's franchise tax bases is determined as follows:

$$\text{Corporation A: } 100\% \times 50\% \div (50\% + 10\%) = 83.33\%$$

$$\text{Corporation B: } 100\% \times 10\% \div (50\% + 10\%) = 16.67\%$$

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

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

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

## **K. Change of Income Year (G.S. 105-122(e))**

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

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

Example: A corporation changes its income year from a calendar year to one ending July 31. A combined franchise and income return is required for the short period January 1, 2007 through July 31, 2007 (seven (7) months). Franchise tax paid on the 2006 return applicable to the calendar year 2007 was \$242.88. Franchise tax on the short period would be applicable to the year August 1, 2007 through July 31, 2008, and would be computed as follows:

Total tax due per return	\$268.00
Less credit for portion of prior year's tax:	
Total tax paid on 2006 return	\$242.88
Less amount applicable to short period (7/12 of \$242.88)	<u>141.68</u>
 Amount applicable beyond short period	 <u>101.20</u>
 Net franchise tax due on short period return	 \$166.80

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

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

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

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

Example: ABC Corporation, whose income year ends July 31, merged into XYZ Corporation, whose income year is the calendar year. The merger occurred on October 31, 2007. ABC filed a combination franchise and income tax return for the year ended July 31, 2007 and paid franchise tax of six hundred dollars (\$600) applicable to the ensuing year ending July 31, 2008. XYZ filed a combination franchise and income tax return for the calendar year 2007 and paid franchise tax of seven hundred dollars (\$700) applicable to the ensuing calendar year 2008. The assets reflected in ABC's tax base were also reflected in XYZ's tax base since they had been transferred to XYZ in the merger, and therefore, were on its books as of the end of its income year, December 31, 2007. The year to which ABC's payment applied overlapped the year to which XYZ's payment applied by seven months (January 1, 2008 through July 31, 2008) and reflected a duplication of tax to that extent.

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

income year in which the transfer occurred, the acquiring corporation may compute its franchise tax on its franchise and income tax return for the income year in which the transfer occurred as shown in the following example:

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

**L. Corporations Conditionally or Partially Exempt (G.S. 105-122, G.S. 105-125)**

**1. Non-Profit Organizations**

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

- a. Fraternal societies, orders or associations. To qualify for income tax exemption, the organization must operate under the lodge system or for the exclusive benefit of members of a fraternity that is operating under the lodge system, and provide life, sick, accident or other benefits to the members or their dependents.
- b. Corporations organized or trusts created for religious, charitable, scientific or educational purposes, including cemetery corporations and organizations for the prevention of cruelty to children and animals.
- c. Business leagues, chambers of commerce, merchants associations and boards of trade.
- d. Civic leagues or organizations operated exclusively for the promotion of civic welfare.
- e. Clubs organized and operated exclusively for pleasure, recreation and other non-profit purposes.
- f. Mutual hail, cyclone and fire insurance companies; mutual ditch, irrigation, canning and breeding associations; mutual or cooperative telephone companies; and like organizations of a purely local character which derive their entire

income from assessments, dues or fees collected from members for the sole purpose of meeting expenses.

- g. Farmer's marketing associations operating as sales agents to market the products of members or other farmers, and to return to them the proceeds, less the necessary selling expenses, on the basis of the quantity of product furnished by them.
- h. Pension, profit-sharing, stock bonus and annuity trusts established by employers for the purpose of distributing both the principal and income thereof exclusively to eligible employees or the beneficiaries of such employees. There must be no discrimination in favor of any particular employee. The interest of individual employees must be irrevocable and nonforfeitable to the extent of contributions by such employees. Exemption of a trust under the Federal income tax law is a prima facie basis for granting exemption from North Carolina franchise and income taxation.
- i. Condominium associations, homeowner associations or cooperative housing corporations not organized for profit.
- j. Cooperative or mutual associations formed under Section 54-124 of the General Statutes to conduct agricultural business on the mutual plan, and marketing associations formed under Section 54-129 of the General Statutes, are exempt from franchise tax.

## **2. Corporations Fully Exempt**

These corporations qualify for the full franchise tax exemption:

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

## **3. Regulated Investment Companies and Real Estate Investment Trusts**

These organizations are required to pay franchise tax; however, in determining their "capital stock, surplus, and undivided profits base" they are allowed to deduct the aggregate market value of investments in the stock, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments.

## **4. Real Estate Mortgage Investment Conduits (REMIC)**

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

**5. Limited Liability Company (LLC)**

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

## **II. CORPORATE INCOME TAX** **(Article 4)**

### **A. Corporations Subject to the Tax, Tax Rate, and Allocation Requirements (G.S. 105-130.3, 105-130.4, 17 NCAC 05C.0100)**

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

All domestic corporations (those chartered in North Carolina) and all foreign corporations which are doing business in North Carolina are subject to income tax and are required to file annual income tax returns, except corporations specifically exempt from the tax under G.S. 105-130.11, and S corporations exempt under G.S. 105-131.

Because of a difference between the State income tax laws and the laws under the North Carolina Business Corporation Act, a foreign corporation operating in North Carolina may be liable for income tax but, at the same time, not be required to obtain a certificate of authority to do business in North Carolina. For example, a Virginia corporation engaged in the general contracting business which obtains a single job in North Carolina to be completed within six months, would not, under the Business Corporation Act, be required to obtain a certificate of authority to do business in this State but would be subject to income tax. Even for a year in which it was inactive or did not earn any net income, a corporation must file an income tax return as a matter of record.

#### **2. “Doing Business” Defined (17 NCAC 05C.0102)**

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

- a. The maintenance of an office or other place of business in North Carolina.
- b. The maintenance in North Carolina of an inventory of merchandise or material for sale, distribution or manufacture, regardless of whether kept on the premises of the taxpayer or in a public or rented warehouse.
- c. The selling or distributing of merchandise to customers in North Carolina directly from a company-owned or operated vehicle when title to the merchandise is transferred from the seller or distributor to the customer at the time of the sale or distribution.
- d. The rendering of a service to clients or customers in North Carolina by agents or employees of a foreign corporation.
- e. The owning, renting, or operating of business or income producing property in North Carolina including, but not limited to, the following:

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

Corporations who are partners in a partnership or joint venture operating in North Carolina are considered to be “doing business.”

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

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

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

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

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

An income tax is levied on the net taxable income of all corporations chartered in North Carolina or doing business in North Carolina, unless they are specifically exempt from tax under G.S. 105-130.11. Net taxable income shall be the same as taxable income as defined in the Internal Revenue Code in effect for the income year for which the returns are to be filed, subject to the adjustments provided in G.S. 105-130.5.

The corporate income tax rate is six and ninety hundredths percent (6.90%).

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

**5. Corporations Required to Allocate Income (G.S. 105-130.4, 17 NCAC 05C.0600)**

A corporation taxable both within and without North Carolina is required to use the allocation and apportionment provisions of G.S. 105-130.4 in reporting its net

income or net loss to North Carolina. For purposes of allocation and apportionment, a corporation is taxable in another state if:

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

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

#### **6. When in Doubt as to Liability**

Any foreign corporation operating in North Carolina that is not certain of its tax status should promptly apply to the Department for a determination of its status. Complete detailed information as to the corporation’s operations should be submitted. All correspondence concerning the matter should be addressed to the Discovery and Special Projects Unit, Central Exam Section, N.C. Department of Revenue, Raleigh, N.C. 27602-0871.

#### **7. Tax Forms**

The corporation income tax return, Form CD-405 or Form CD-401S, is available from the Department of Revenue in Raleigh or from any of the branch offices located throughout the State. The returns and other related schedules are also available from the Department’s web site at [www.dornrc.com](http://www.dornrc.com).

### **B. Tax Credits**

Taxpayers are allowed various tax credits in Chapter 105 of the General Statutes. Article 3A provides credits for new and expanding businesses. Article 3B provides business and energy credits. Article 3C provides credits for recycling facilities. Article 3D provides historic rehabilitation credits. Article 3E provides low-income housing tax credits. Article 3F provides research and development tax credits. Article 3G provides tax credits for major computer manufacturing facilities. Article 3H provides tax credits for mill rehabilitation. Article 3J provides tax credits for growing businesses. Article 3K provides tax credits for railroad intermodal facilities. Other general credits are provided in G.S. 105-130.22 through 105-130.48. Specific information on these credits is found in the “Tax Credits” section.

### **C. Computation of Net Income (G.S. 105-130.3, G.S. 105-130.5)**

#### **1. Preliminary Statement**

To compute State net income or net loss, a corporation uses its Federal taxable income as defined in the Internal Revenue Code in effect for the tax year for which the return

is to be filed as a beginning point and adds thereto or deducts therefrom the items listed below.

To simplify the preparation and filing of its State income tax return, a corporation may attach a copy of its Federal income tax return and supporting schedules in lieu of completing the corresponding schedules in its State return.

## **2. Adjustments to Federal Taxable Income**

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

- a. Taxes based on or measured by net income by whatever name called and excess profits taxes.
- b. Interest paid in connection with income exempt from State income taxation. See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."
- c. The contributions deduction allowed by the Internal Revenue Code.
- d. Interest income earned on bonds and other obligations of other states or their political subdivisions, less allowable amortization on any bond acquired on or after January 1, 1963.
- e. The amount by which gains have been offset by the capital loss carryover allowed under the Internal Revenue Code. All gains recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.
- f. The net operating loss deduction allowed by the Internal Revenue Code.
- g. Payments to or charges by a parent, subsidiary or affiliated corporation in excess of fair compensation in all intercompany transactions of any kind whatsoever.
- h. The amount of all income tax credits claimed against the corporation's income tax liability during the income year. In lieu of the add-back of tax credits to federal taxable income, taxpayers must reduce the amount of credit available by the current income tax rate. See Form CD-425.
- i. Percentage depletion in excess of cost depletion applicable to mines, oil and gas wells and other natural deposits located outside this State.
- j. The amount allowed under the Code for depreciation or as an expense in lieu of depreciation for a utility plant acquired by a natural gas local distribution company, to the extent the plant is included in the company's rate base at zero cost in accordance with G.S. 62-158.

- k. Royalty payments for the use of intangible property in this State made to a related member and deducted as an expense by a payer in arriving at federal taxable income if the election is made under G.S. 105-130.7A for the recipient to exclude the royalty income from its income. Intangible property is defined as copyrights, patents, and trademarks. A taxpayer is not required to add back royalty payments for the use of intangible property in this State made to a related recipient that is organized under the laws of another country if the country has a comprehensive income tax treaty with the United States and imposes a tax on royalty income of the recipient at a rate that is equal to or exceeds the State's corporate income tax rate. See G.S. 105-130.7A for definitions.
- l. The gross income from international shipping activities excluded from federal taxable income because the corporation elects to be subject instead to a tonnage tax under Subchapter R of Chapter 1 of the Code.
- m. The gross income from domestic production activities excluded from federal taxable income under Section 199 of the Code.
- n. The dividend paid deduction allowed to a captive Real Estate Investment Trust. A captive REIT is one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to NC corporate income tax. REITS owned by other REITS or listed Australian property trusts are excluded from the definition.
- o. The amount of a donation to a nonprofit organization for acquisition or lease of renewable energy property made by a taxpayer who claimed a tax credit under G.S. 105-129.16H Effective taxable years beginning on or after January 1, 2008.

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

- a. Interest upon the obligations of the United States or its possessions, to the extent included in federal taxable income. However, interest upon obligations of the United States shall not be an allowable deduction unless interest upon obligations of the State of North Carolina or any of its political subdivisions is exempt from income tax imposed by the United States. See subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."
- b. Interest (net of expenses) received from obligations of the State of North Carolina, a political subdivision of this State, a commission, authority, or another agency of this State, and a nonprofit educational institution organized or chartered under the laws of this State to the extent included in federal taxable income.

- c. Payments received from a parent, subsidiary, or affiliated corporation in excess of fair compensation in intercompany transactions which in the determination of the net income or net loss of such corporation were not allowed as a deduction under this State's revenue laws.
- d. Dividends treated as received from sources outside the United States, as determined under section 862 of the Code, net of related expenses, to the extent included in federal taxable income. The netting of related expenses shall be calculated in accordance with G.S. 105-130.5(c)(3) and G.S. 105-130.6A.
- e. Any amount included in federal taxable income under section 78 or section 951 of the Code, net of related expenses.
- f. Net economic losses incurred by the corporation in any or all of the fifteen (15) preceding years pursuant to the provision of G.S. 105-130.8. For specific instructions with respect to net economic loss determination and requirements applicable to multistate corporations, see Subject "Net Economic Loss Carry-Over."
- g. Contributions or gifts made by the corporation within the income year to the extent provided under G.S. 105-130.9. See Subject "Deduction of Contributions."
- h. Amortization in excess of depreciation allowed for Federal income tax purposes on the cost of sewage, waste or air pollution facilities; recycling and resource recovering facilities; or hazardous waste disposal facilities as provided in G.S. 105-130.10. See Subject "Rapid Amortization of Air or Water Pollution Abatement, Recycling and Resource Recovering, Sewage, and Hazardous Waste Facilities."
- i. Depreciation of emergency facilities acquired prior to January 1, 1955. Any corporation shall be permitted to depreciate any emergency facility, as defined in section 168 of the Internal Revenue Code in effect prior to 1976, over its useful life, provided such facility was acquired prior to January 1, 1955, and no amortization has been claimed on such facility for State income tax purposes.
- j. The amount of losses realized on the sale or other disposition of assets not allowable under section 1211(a) of the Internal Revenue Code. All losses recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.
- k. 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.

- l. The amount by which a deduction for an ordinary and necessary business expense on the corporation's federal income tax return was reduced and not allowable as a deduction because the corporation claimed in lieu of such amount a tax credit against its federal income tax due for the income year.
- m. Reasonable expenses, in excess of deductions allowed for federal income tax purposes, paid for reforestation and cultivation of commercially grown trees, except that the deduction shall be allowed only to those corporations whose real owners are natural persons actively engaged in the commercial growing of trees, or the spouse, siblings, or parents of such persons. In no case shall a corporation be allowed a deduction for the same cultivation or reforestation expenditure more than once.
- n. The amount by which the basis of a depreciable asset has been reduced on account of a tax credit allowed for federal tax purposes.
- o. Market assessments paid by the corporation on tobacco grown in North Carolina.
- p. The amount of natural gas expansion surcharges collected by a natural gas local distribution company under G.S. 62-158.
- q. The amount of 911 service charges collected under G.S. 62A-5 and remitted to a local government under G.S. 62A-6, the amount of wireless Enhanced 911 service charges collected under G.S. 62A-23 and remitted to the Wireless Fund under G.S. 62A-24, to the extent included in federal taxable income. Effective January 1, 2008, the 911 charges imposed under G.S. 62A-43 and remitted to the 911 Fund under that section.
- r. 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, if the trust meets all of the conditions set forth in G.S. 105-130.5(b)(18).
- s. Hurricane relief or assistance payments made to taxpayer by the Office of State Budget, Planning, and Management from the Hurricane Floyd Reserve Fund to the extent included in federal taxable income. Compensation paid from the Fund to the taxpayer for goods or services is not deductible.
- t. Royalty payments received for the use of intangible property in this State by a recipient from a payer that is a related member, if the election is made under G.S. 105-130.7A for the payer to exclude the royalty payments from its expenses deduction. Intangible property is defined as copyrights, patents, and trademarks. See G.S. 105-130.7A for definitions.

- u. In each of the taxpayer's first five taxable years beginning on or after January 1, 2005, an amount equal to twenty percent (20%) of the amount added to taxable income in a previous year as accelerated depreciation under G.S. 105-130.5(a)(15). For pass-through entities, the deduction is available only to the taxpayer that reported the addition in arriving at taxable income.
- v. To the extent included in federal taxable income, the amount received from the Disaster Relief Reserve Fund in the Office of State Budget and Management for hurricane relief or assistance. This deduction does not include payments for goods or services provided by the taxpayer.
- w. The amount of dividend received from a captive Real Estate Investment Trust. A captive REIT is one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to NC corporate income tax. REITS owned by other REITS or listed Australian property trusts are excluded from the definition.

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

- a. In determining State net income, no deduction shall be allowed for annual amortization of bond premiums applicable to any bond acquired prior to January 1, 1963. The amount of premium paid on any such bond shall be deductible only in the year of sale or other disposition.
- b. Federal taxable income must be increased or decreased to account for any difference in the amount of depreciation, amortization, or gains or losses applicable to property that has been depreciated or amortized by use of a different basis or rate for State income tax purposes than used for federal income tax purposes.
- c. No deduction is allowed for any direct or indirect expenses related to income not taxed, except no adjustment is made under this subsection for adjustments addressed in G.S. 105-130.5(a) and (b) and in G.S. 105-130.6A. See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."
- d. Federal taxable income must be adjusted in instances where the taxable income change caused by the recovery of previously deducted amounts may be different for state income tax purposes.
- e. A saving and loan association may deduct interest earned on deposits at the Federal Home Loan Bank of Atlanta to the extent included in federal taxable income.

### **3. Miscellaneous**

#### **a. Depreciation Recapture**

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

#### **b. Unrealized Income from Installment Sales Taxable upon Termination of Business**

A corporation which withdraws from this State, dissolves, merges, or consolidates its business, or terminates its business in this State by any other means whatsoever is required to file a final income tax return within seventy-five (75) days after the close of business. If the corporation uses the installment method of reporting income, all unrealized or unreported income from installment sales made while doing business in this State must be included in State net income on the final return.

#### **c. International Banking Facility**

Net income or loss from an international banking facility included in the corporation's federal taxable income shall be excluded in determining State taxable income.

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

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

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

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

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

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

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

Net interest from obligations issued under the borrowing power of a Federal Land Bank, a Federal Home Loan Bank, a Federal Intermediate Credit Bank, Farm Home Administration, Export-Import Bank of the U.S., Tennessee Valley Authority, Banks for Cooperatives, Student Loan Marketing Association, Federal Farm Credit Bank, Federal Financing Bank, Federal Savings and Loan Insurance Corporation, Commodity Credit Corporation, Resolution Funding Corporation, Production Credit Association, and United States Postal Service is considered to be interest from obligations of the United States and is tax exempt.

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

Gain or loss realized on the sale or other disposition of any type of obligation of the United States or its possessions, the State of North Carolina or its political

subdivisions, any other state or its political subdivisions, or of any other government is a taxable transaction and must be included in the computation of a corporation's State taxable income.

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

Example 1: Interest on bonds, notes, debentures or other evidence of the indebtedness issued under G.S. 131E-28 by the North Carolina Hospital Authorities, including gain from the sale or exchanges of these obligations.

Example 2: Interest and gain derived from obligations issued by the North Carolina Housing Finance Agency under G.S. 122A-19.

Example 3: Interest and gain derived from bonds issued under the Joint Municipal Electric Power and Energy Act under G.S. 159B-26.

Example 4: Interest on bonds, notes, debentures, or other evidence of indebtedness issued by the North Carolina Medical Care Commission under the Health Care Facilities Finance Act under the provisions of G.S. 131A-21. Gain from the sale or exchange of these obligations may also be excludible.

Example 5: Interest and gain on bonds issued by the North Carolina State Ports Authority under G.S. 143B-456(g).

Example 6: Interest on bonds, notes, debentures, and any other evidence of indebtedness issued by a North Carolina Housing Authority (including any corporate agent authorized by Article 1 of Chapter 157 of the General Statutes to exercise the powers of the authority) under the provisions of G.S. 157-26. Gain from the sale or exchange of these obligations is not excludible.

Example 7: Interest on bonds issued by the authorities created under the Industrial and Pollution Control Facilities Financing Act, G.S. 159C-14.

Example 8: Income from securities, evidence of indebtedness, and shares of capital stock issued by a corporation to promote, develop, and advance the prosperity and economic welfare of the State of North Carolina under the provisions of G.S. 53A-15. Gain from the sale or exchange of such obligations is excludible.

Example 9: Income from bonds issued by boards of trustees of State supported colleges and universities in North Carolina including any gain from the sale or exchange of such bonds under G.S. 116-183 and G.S. 116-196.

Example 10: Interest and gain received from bonds and notes issued under the provision of the Higher Education Facilities Act by the North Carolina Educational Facilities Finance Agency under G.S. 115E-21.

Example 11: Interest and gain received on obligations issued under Chapter 122D (the North Carolina Agriculture Finance Act) by the North Carolina Agriculture Finance Authority under G.S. 122D-14.

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

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

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

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

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

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

**E. Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property (G.S. 105-130.4, G.S. 105-130.5, G.S. 105-130.6A, 17 NCAC 05C.0304)**

**1. Direct Expenses**

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

**2. Interest Expense**

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

a. Assets

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

value may be excluded and the reserve for depreciation reflected on the balance sheet may be restored to the asset value.)

- iii. Determine the ratio or percentage of i to ii
- b. Income
    - i. Gross Untaxed Income
    - ii. Total Gross Profits
    - iii. Determine the ratio or percentage of i to ii
  - c. Total of the ratios or percentages determined in a and b above.
  - d. Divide total of c by 2
  - e. Apply average percentage determined in d to the total interest expense on the return filed in this State.

Examples of untaxed income:

- Dividend income classified as nonapportionable (G.S. 105-130.4)
- Interest income classified as nonapportionable (G.S. 105-130.4)
- Interest income earned on United States obligations (see 3 below) and State of North Carolina obligations
- Other nonapportionable income and/or exempt income

### **3. Expense Connected With Interest Income From United States Obligations**

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

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

### **4. Expenses Related to Dividends Received**

For corporations other than bank holding companies or electric power holding companies, the amount of expenses attributed to dividends is limited to fifteen percent (15%) of the dividends. For bank holding companies, the amount of expenses attributed to dividends is limited to twenty percent (20%) of the dividends. For

electric power holding companies, the amount of expenses attributed to dividends is limited to fifteen percent (15%) of the company's total interest expenses.

The additional tax that a bank holding company and its related companies must pay as the result of attributing expenses to dividends received shall not exceed eleven million dollars (\$11,000,000). If the attribution of expenses results in additional tax of more than eleven million dollars (\$11,000,000) to the bank holding company group, the group may reduce the attributed expenses so that the additional tax effect is eleven million dollars (\$11,000,000).

The members of the group may allocate the reduction among themselves at their discretion. Each member of the group that has dividends for the year and is required to file a North Carolina return must provide a schedule with its return that lists each member of the group that has dividends, the amount of the dividends, whether that member is a bank holding company, and the amount of expenses attributed to that member in order to reach the cap of eleven million dollars (\$11,000,000). If a member's return is later adjusted so that the tax effect of the attribution of expenses for the group falls below eleven million dollars (\$11,000,000), the Department may increase the amount of attributed expenses for any member of the group to bring the additional tax back to the maximum. The Department may assess any additional tax due within three years of the date on which the member's return was changed that resulted in the group falling below the maximum tax effect.

The members of a bank holding company are allowed a tax credit for a portion of the additional tax liability. This tax credit can be allocated among the group at their discretion. If the bank holding company group pays the maximum additional tax liability of eleven million dollars (\$11,000,000), the credit is two million dollars (\$2,000,000). If the bank holding company group does not pay an additional eleven million dollars (\$11,000,000), the credit is equal to the additional tax the group paid by attributing expenses of up to twenty percent (20%) of dividends instead of fifteen percent (15%) of dividends. The credit is taken in four equal annual installments and is taken beginning in the following tax year.

An electric power holding company is allowed a credit equal to one-half of the additional tax paid as a result of attributing expenses to dividends received. The electric power holding company may claim the credit against its own tax liability or may elect to allocate the credit among the members of its affiliated group. If the electric power holding company claims the credit against its own tax liability, the credit is allowed in the following tax year. If the electric power company elects to allocate the credit among the members of its affiliated group, the credit must be taken in four equal installments beginning in the following tax year or the taxable year for which the taxpayer's final return is due for 2004, whichever is later.

The credits allowed for bank holding companies and electric power holding companies can be taken against either the corporate income or franchise tax. However, the credit may be claimed against only one of the taxes. Each taxpayer must elect the tax against which the credit will be taken when filing the return on which the first installment of

the credit is claimed. This election is binding. All installments and carryforwards of the credit must be taken against the same tax.

In order for a member of an affiliated group to take a credit, each member of the affiliated group that is required to file a corporate income tax or franchise tax return must attach a schedule to its return that shows for every member of the group the amount of the credit taken by it, the tax against which it is taken, and the amount of the resulting tax. In addition, each member must provide any other documentation required by the Secretary.

A credit allowed in this section may not exceed the amount of the tax against which it is taken for the taxable year reduced by the sum of all credits allowable, except tax payments made by or on behalf of the taxpayer. Any unused portion of the credit may be carried forward to succeeding tax years.

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

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

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

### **F. Allocation and Apportionment Procedures (G.S. 105-130.4)**

#### **1. Preliminary Statement**

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

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

#### **2. Alternate Apportionment Formula**

If any corporation believes that the statutory allocation formula allocates a greater portion of its income than is reasonably attributable to business or earnings in this State, it may make a written request with the Secretary of Revenue for permission to

use an allocation formula that it believes is a better method to allocate its income to North Carolina.

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

If the request for an alternative method of apportionment is granted, the order can apply to no more than three years. If the request is denied, the Secretary's decision is final and is not subject to administrative or judicial review. A corporation authorized to use an alternative formula may apportion its capital stock base using the alternative method or the statutory method.

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

#### **a. Determine Net Income Everywhere**

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

#### **b. Determine Nonapportionable Income**

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

#### **c. Determine Apportionable Income**

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

#### **d. Compute Apportionment Factors**

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

**e. Apportion Income to North Carolina**

The corporation determines the amount of its apportionable income or loss attributable to North Carolina by applying the factor computed in Item d to the total business income or loss as computed in Item c.

**f. Determine Total Income Allocable to North Carolina**

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

**g. Percentage Depletion Deduction Before Net Economic Loss Deduction**

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

**h. Determine Total North Carolina Income Before Deductions for Contributions to North Carolina Donees**

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

**i. Determine Total Net Taxable Income in North Carolina**

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

**G. Taxable in Another State (G.S. 105-130.4, 17 NCAC 05C.0600)**

**1. Preliminary Statement**

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

**2. Definition of Taxpayer**

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

**3. Taxable in Another State – In General**

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

1. If by reason of business activity in another state the taxpayer is "subject to" a

net income tax or any other tax measured by net income.

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

#### **4. Taxable in Another State – When a Taxpayer is “Subject To” Tax**

- a. A taxpayer is “subject to” one of the taxes specified above only if it carries on business activities in another state. If the taxpayer voluntarily files and pays such tax when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but
  - Does not actually engage in business activities in that state, or
  - Does actually engage in some activity not sufficient for nexus and the minimum tax bears no relation to the corporation’s activities within such state, the taxpayer is not “subject to” tax within that state and is therefore not “taxable” in another state.

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

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

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

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

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

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

#### **5. Taxable in Another State – When a State has Jurisdiction to Subject a Taxpayer to a Net Income Tax**

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

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

### **H. Apportionable and Nonapportionable Income (G.S. 105-130.4, 17 NCAC 05C.0700)**

#### **1. Division of Income – In General**

When a taxpayer has income from sources within this State as well as income from sources outside this State, the division of income and the resulting determination of the portion of the taxpayer’s entire net income that is attributable to this State shall be determined pursuant to the allocation and apportionment provisions set forth in G.S. 105-130.4. In such cases, the first step is to determine which portion of the taxpayer’s entire net income constitutes “apportionable income” and which portion constitutes “nonapportionable income”. The various items of nonapportionable income are then directly allocated to specific jurisdictions pursuant to the provisions of subsections (d) through (h) of G.S. 105-130.4. The apportionable income of the

taxpayer other than public utilities and excluded corporations is divided between the jurisdictions in which the business is conducted pursuant to the property, payroll and sales apportionment factors set forth in subsections (j) through (1) of G.S. 105-130.4. The sum of (1) the items of nonapportionable income directly allocated to this State, plus (2) the amount of apportionable income attributable to this State by the apportionment formula generally constitutes the amount of the taxpayer's entire net income that is subject to tax under the income tax laws of this State.

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

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

## **2. Apportionable and Nonapportionable Income Defined**

The Revenue Act defines "apportionable income" as all income that is apportionable under the United States Constitution. For purposes of administration of G.S. 105-130.4, the income of the taxpayer is apportionable income unless clearly classifiable as nonapportionable income under the law and these regulations. Nonapportionable income means all income other than apportionable income.

## **3. Apportionable and Nonapportionable Income – Application of Definitions**

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

## **4. Proration of Deductions Related to Apportionable and Nonapportionable Income**

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

# **I. Apportionment Factors (G.S. 105-130.4)**

## **1. General Business Corporations**

Corporations engaged in multistate business activity, other than public utilities and excluded corporations, are required to apportion to this State all apportionable

income by using a four-factor formula. The apportionment formula consists of the sum of the property factor, the payroll factor and twice the sales factor divided by four. If the sales factor does not exist, the denominator is the number of existing factors. If a property or payroll factor does not exist, the denominator is the number of existing factors plus one. The only time a factor does not exist is when there is no denominator. When there is a denominator for a particular factor, but no numerator, the factor is zero and becomes part of the apportionment factor.

**a. Property Factor (G.S. 105-130.4, 17 NCAC 05C.0800)**

**i. Property Factor – In General**

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

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

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

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

**ii. Property Factor – Property Used for the Production of Apportionable Income**

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

**iii. Property Factor – Consistency in Reporting**

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

**iv. Property Factor – Numerator**

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

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

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

**v. Property Factor – Valuation of Owned Property**

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

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

Example 1: Taxpayer acquired a factory building in this State at a cost of five hundred thousand dollars (\$500,000) and years later, expended one hundred thousand dollars (\$100,000) for major remodeling of the building. Taxpayer files its return on the calendar year basis and claims a depreciation deduction

in the amount of twenty-two thousand dollars (\$22,000) on the building. The value of the building includible in the numerator and denominator for the property factor is six hundred thousand dollars (\$600,000), as the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

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

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

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

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

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

**vi. Property Factor – Rented Property**

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

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

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

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

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

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

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

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

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

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

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

**vii. Property Factor – Averaging Property Values**

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

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

**b. Payroll Factor (G.S. 105-130.4, 17 NCAC 05C.0900)**

**i. Payroll Factor – In General**

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

**ii. Payroll Accounting Method**

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

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

**iii. The Term “Compensation”**

The term “compensation” means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as

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

**iv. The Term “Employee”**

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

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

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

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

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

**vi. Denominator of Payroll Factor**

Except as provided above, the denominator of the payroll factor is the total compensation paid everywhere during the income year. Accordingly,

compensation paid to employees whose services are performed entirely in a state where the taxpayer is exempt from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

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

**vii. Numerator of Payroll Factor**

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

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

1. The employee's service is performed entirely within the State.
2. The employee's service is performed both within and without the State, but the service performed without the State is incidental to the employee's service within the State. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.
3. If the employee's services are performed both within and without this State, the employee's compensation will be attributed to this State, if:
  - The employee's base of operations is in this State; or
  - There is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this State; or
  - The base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee's residence is in this State.

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

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

**viii. Corporations Utilizing Common Paymaster**

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

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

**c. Sales Factor (G.S. 105-130.4, 17 NCAC 05C.1000)**

**i. Sales Factor – Sales Made in General Business Operations**

Subsection (a) (7) of G.S. 105-130.4 defines the term “sales” to mean all gross receipts of the taxpayer except receipts from the “casual sale” of property, receipts allocated under subsections (c) through (h) of G.S. 105-130.4, receipts exempt from taxation, and the portion of receipts realized from the sale or maturity of securities or other obligations that represents a return of principal. Thus, for the purposes of the sales factor, the term “sales” means generally all gross receipts derived by a taxpayer from transactions and activities in the course of its regular trade or business operations which produce apportionable income within the meaning of subsection (a) (1) of G.S. 105-130.4.

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

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

**ii. Sales Factor – Sales Incidental To General Business Operations**

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

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

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

**iii. Sales Factor – Sales Made In Other Types of Business Activity**

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

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

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

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

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

**iv. Sales Factor – Numerator**

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

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

**v. Sales Factor – What Sales of Tangible Personal Property Are In This State**

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

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

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

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

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

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

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

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

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

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

**vi. Sales Factor – Sales To United States Government**

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

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

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

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

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

G.S. 105-130.4(1)(3) contains provisions for including gross receipts from other business income transactions in the numerator of the sales factor. Under this subsection gross receipts are attributed to this State, if:

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

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

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

1. Gross receipts from the sale, lease, rental or other use of real property are in this State if the real property is located in this State.
2. Gross receipts from the sale of electricity if the location of the income producing activity is located in this State.
3. Gross receipts from the rental, lease, licensing the use of, or other use of tangible property shall be assigned to this State if the property is within this State during the entire period of rental, lease, license or other use. If the property is within and without this State during such period, gross receipts attributable to this State shall be based upon the ratio which the time the property was physically present or was used in this State bears to the total time or use of the property everywhere during such period.
4. Gross receipts from intangible personal property shall be attributed to this State if they are received from sources within this State.

Example 1: Royalties from trademarks are attributed to this State to the extent the royalties are received as a result of sales within this State.

Example 2: Royalties from patents, secret processes, or other similar intangible property are attributed to this State to the extent the patent,

secret process, or other similar intangible property is employed in production, fabrication, manufacturing, processing, or other similar use in this State.

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

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

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

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

5. Gross receipts for the performance of personal services are attributable to this State to the extent such services are performed in this State. If the services are performed partly within and without this State, such receipts shall be attributed to this State based upon the ratio which the time spent in performing such services in this State bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

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

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

in this State. The receipts attributable to this State are three thousand dollars (\$3,000).

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

**2. Public Utilities, Excluded Corporations and Air or Water Transportation Corporations Apportionment Factors (G.S. 105-130.4)**

**a. Railroad Companies**

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

**b. Telephone Companies**

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

**c. Motor Carriers of Property and/or Passengers**

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

**d. Telegraph Companies**

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

**e. Excluded Corporations, including Construction Contractors, and Other Public Utilities**

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

classified in the North American Industry Classification System (NAICS) published by the Federal Office of Management and Budget.

**f. Air or Water Transportation Corporations**

All apportionable income of an air or water transportation corporation must be apportioned by a fraction, the numerator of which is the corporation's revenue ton-miles in this state and the denominator of which is the corporation's revenue ton-miles everywhere. The term "revenue ton-mile" means one ton of passengers, freight, rail, or other cargo carried one mile. In making this computation, a passenger is considered to weigh two hundred pounds.

Revenue ton-miles in this State are determined for air transportation companies from the flights, landings and/or departures from locations in this State; and for water transportation companies from dockings and/or departures from locations in this State.

**J. Deduction of Contributions (G.S. 105-130.9(1), (2) and (3))**

**1. Preliminary Statement**

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

**2. Charitable Contribution Defined**

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

**3. Contributions Limited to Five Percent (5%) of Net Income (G.S. 105-130.9(1))**

The deduction for contributions made to qualified organizations other than contributions made to the State of North Carolina, a municipality in North Carolina, or any of their institutions, instrumentalities, or agencies, and to qualified educational institutions located within North Carolina are limited to an amount not exceeding five percent (5%) of the corporation's net income as determined before the deductions for contributions. State law does not permit a corporation to carryover unused contributions to subsequent years.

**4. Contributions Fully Deductible (G.S. 105-130.9(2))**

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

hold, invest and administer property and to make expenditures to or for the sole benefit of an educational institution or group of such institutions.

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

The allowable contributions deduction is computed as follows:

Net income	\$1,000
Add: Contributions	<u>200</u>
Net income before net economic loss deductions	\$1,200
Less: Net economic loss brought forward	<u>500</u>
Net income before contributions deduction	\$ 700
Less allowable contributions:	
Other qualified donees (not to exceed 5% of \$700)	35
College located in North Carolina	50
North Carolina county agency	<u>100</u>
	\$ <u>185</u>
Net taxable income	\$ 515

#### **5. Contributions by Corporations Allocating Net Income (G.S. 105-130.9(3))**

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

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

Example: Corporation C's records show net income of one hundred fourteen thousand dollars (\$114,000) before the deductions for a net economic loss and contributions.

Contributions total six thousand two hundred dollars (\$6,200) and include two hundred dollars (\$200) to a North Carolina agency, two thousand dollars (\$2,000) to other North Carolina donees and four thousand dollars (\$4,000) to qualified donees located outside North Carolina.

The deduction for contributions is determined as follows:

Net income before contributions and net economic loss deduction	114,000
Less: Contributions to donees outside North Carolina	<u>4,000</u>
Total	\$110,000
Less: Total nonapportionable income	<u>10,000</u>
Total apportionable income	\$100,000
Apportionable to North Carolina —35%	\$ 35,000
Add: Nonapportionable income directly allocated to North Carolina	<u>1,000</u>
Total income allocated to North Carolina	\$ 36,000
Less: Allowable portion of net economic loss deduction	<u>6,000</u>
Total income allocated to N C before contributions to donees	\$ 30,000
Less: Contributions	
North Carolina donees (not to exceed 5% of \$30,000)	\$1,500
North Carolina county agency	<u>200</u>
	\$ <u>1,700</u>
Net taxable income	\$ 28,300

**6. Contributions When Taxpayer Claims Tax Credit (G.S. 105-130.9(4))**

The amount of a contribution for which a taxpayer claims a tax credit for certain real property donations (G.S. 105-130.34) or for oyster shell recycling (G.S. 105-130.48) cannot be deducted as a contribution. In those cases, the taxpayer is not required to reduce the amount of the credit by the income tax rate pursuant to G.S. 105-130.5(a)(10).

**K. Rapid Amortization for Qualifying Facilities and Equipment (G.S. 105-130.10, G.S. 105-130.10A)**

**1. Rapid Amortization of Air or Water Pollution Abatement, Recycling and Resource Recovering, Sewage and Hazardous Wastes Facilities**

A corporation may, at its option and in lieu of any regular depreciation allowance, recover over a period of sixty (60) months its costs of any air-cleaning device; sewer

or waste treatment plant including waste lagoons; pollution abatement equipment; recycling and resource recovering facilities; sewer service facilities to residential and outlying areas built by public or private utilities; and facilities built to reduce the volume of hazardous wastes generated.

## **2. Certification of Facilities Required**

The deduction for rapid amortization of the facilities and equipment described above shall be allowed only upon the condition that the corporation furnish the Secretary of Revenue a certificate from the Department of Environment and Natural Resources or the Environmental Management Commission certifying the air cleaning and waste treatment facilities comply with the Commission's requirements. The recycling facilities also require a certificate from the Department of Environment and Natural Resources.

## **3. Rapid Amortization of Equipment Mandated by OSHA**

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

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

## **L. Amortization of Bond Premiums (G.S. 105-130.5, 17 NCAC 05C.1400)**

### **1. Preliminary Statement**

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

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

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

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

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

## 2. Tax-Exempt Bonds

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

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

Sales price	\$5,100
Basis of bond sold:	
Cost	\$5,100
Less: Premium amortized	<u>40</u>
	<u>\$5,060</u>
Gain	\$ 40

## 3. Taxable Bonds

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

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

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

Sales price	\$12,375
Basis of bond sold:	
Cost	\$12,500
Less: Premium amortized	<u>250</u>
	<u>\$12,250</u>
Gain	\$ 125

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

Sales price	\$12,375
Basis of bond sold:	
Cost	<u>\$12,500</u>
Loss	(\$ 125)

#### 4. Definition of Bond

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

### M. Net Economic Loss Carry-Over (G.S. 105-130.8)

#### 1. Preliminary Statement

In order that some measure of relief may be granted to corporations which have incurred economic misfortune or which are otherwise materially affected by strict adherence to the annual accounting rule in determining taxable income, the statute provides for the carrying forward of a net economic loss for a period of fifteen (15) years. A net economic loss carried forward from any year shall first be applied to, or offset by, any income taxable or nontaxable of the next succeeding year before any portion of the loss may be carried forward to a succeeding year.

Note: The fifteen-year carryforward period applies only to losses incurred in tax years beginning on or after January 1, 1993. Losses incurred in tax years beginning before January 1, 1993 could be carried forward for only five years.

#### 2. Differences Between North Carolina and Federal Provisions

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

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

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

**3. Definition of Net Economic Loss**

A net economic loss is the amount by which allowable deductions, other than prior years' losses, exceed income from all sources in the year including any income not taxable. *Dayco Corporation v. Clayton*, Commissioner of Revenue (1967), 269 N.C. 490, 153 S.E. 2nd 28.

**4. Income Not Taxable**

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

**5. Procedure for Deducting a Net Economic Loss**

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

**6. Corporations Allocating Their Net Income (17 NCAC 05C.1506)**

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

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

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

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

1. The “but-for” test, which allows the deduction if, but for the merger, the corporation suffering the loss would have been able to utilize the deduction;
2. The “assets” test, which allows the deduction only to the extent that the group of assets that was previously operated at a loss is operated at a profit after the merger. Accounting records must show clearly the income and expenses attributable to such groups of assets; and
3. The “substantially the same business” test, which allows the deduction if the business of the acquired corporation which sustained the loss has not been materially altered or enlarged by the merger.

See Good Will Distributors (Northern) Inc. v. Currie, Commissioner of Revenue (1959) 251 N.C. 120, 110 S. E. 2nd 880; Holly Farms Poultry Industries, Inc. v. Clayton, Commissioner of Revenue (1970) 9 N.C. App. 345, 176 S.E. 2nd 367; Fieldcrest Mills, Inc. v. Coble, (1976), 290 N.C. 504, 135 S.E. 2nd 205; Bellsouth Telecommunications, Inc., d/b/a Southern Bell Telephone and Telegraph Company v. Department of Revenue (1997), 485 SE2d 333.

## 8. Examples

The following examples show the proper method of computing net economic losses and the correct procedure for carrying them forward as deductions.

Example 1: Corporation X, a North Carolina corporation, conducts its entire business in this State. The corporation had a net loss of ten thousand dollars (-\$10,000) in 2006 and net income of twenty thousand dollars (\$20,000) in 2007. In each year, the corporation received five hundred dollars (\$500) from U.S. government obligations and five hundred dollars (\$500) from State of North Carolina bonds. Interest on North Carolina bonds and interest on U.S. obligations were deducted in computing State net income and net loss.

### Determination of Net Economic Loss

Net loss for 2006		(\$10,000)
Reduced by income not taxable:		
U. S. Government interest	\$ 500	
N.C. bond interest	<u>500</u>	
		<u>1,000</u>
Net economic loss for 2006		(\$ 9,000)

### Computation of Net Economic Loss Deduction

Net loss brought forward from 2006		(\$ 9,000)
Reduced by income not taxable received in 2007:		
U. S. Government interest	\$500	
N.C. bond interest	<u>500</u>	
		<u>1,000</u>
Net economic loss deduction in 2007		(\$ 8,000)

### Computation of 2007 Net Taxable Income

Net income for 2007	\$20,000
Less: Net economic loss deduction (from above)	<u>( 8,000)</u>
Net taxable income	\$12,000

Example 2: Corporation Y is a North Carolina corporation engaged in the business of manufacturing and selling chemicals and related products within and without this State. Its business is directed or managed from its North Carolina offices; therefore its commercial domicile is in this State. The corporation had a net loss of twenty-two thousand five hundred dollars (-\$22,500) in 2006 and net income of twenty-one thousand five hundred dollars (\$21,500) in 2007.

The arithmetical average of the apportionment factors of property, payroll and sales was sixty percent (60%) in 2006 and seventy percent (70%) in 2007.

The corporation received nontaxable interest of eight hundred dollars (\$800) in 2006 and six hundred dollars (\$600) in 2007 on U.S. government bonds.

In determining net loss and net income in the above years, the corporation included the following income and deduction items:

- a. Contributions of one thousand dollars (\$1,000) to North Carolina donees were deducted in each year. Included in this deduction for each year were fully deductible contributions of five hundred dollars (\$500) to qualified educational institutions in North Carolina.
- b. Nonapportionable rental income, less related expenses, of two thousand dollars (\$2,000) was received in each year on a building located outside North Carolina. (Note: Since the rental income was received on nonapportionable real property, it is allocated directly to the state in which the property was located.)

- c. A gain of five hundred dollars (\$500) in 2006 and a loss of five hundred dollars (-\$500) in 2007 were realized on the sale of U.S. government bonds. (Note: Since the commercial domicile of Corporation Y is in North Carolina, such nonapportionable gains or losses on intangible property are allocated directly to this State.)
- d. Nonapportionable dividend income of one thousand dollars (\$1,000) (net nonapportionable dividend income) was received in each year. (Note: Since the commercial domicile of Corporation Y is in North Carolina, such net nonapportionable dividend income is allocated directly to this State.)

### Computation of Net Economic Loss

Net loss for 2006	(\$22,500)
Add: Contributions	<u>1,000</u>
Total	(\$21,500)
Less total nonapportionable income:	
Net rental income	\$2,000
Gain on bonds sold	500
Net nonapportionable dividends	<u>1,000</u>
	\$ <u>3,500</u>
Total apportionable income (loss)	(\$25,000)
Apportionable to North Carolina—60%	(\$15,000)
Add nonapportionable income allocated directly to N C:	
Gain on bonds sold	\$ 500
Net nonapportionable dividends	<u>1,000</u>
	\$ <u>1,500</u>
Total	(\$13,500)
Less: Contributions to educational institutions located in N. C	\$ <u>500</u>
Total	(\$14,000)
Less income not taxable in North Carolina:	
U.S. Government interest (60% of \$800)	\$ 480
Net rental income (60% of \$2,000)	<u>1,200</u>
	\$ <u>1,680</u>
Net economic loss for 2006	(\$12,320)

### Computation of Net Economic Loss Deduction

Net economic loss brought forward from 2006		(\$12,320)
Reduced by nontaxable income received in 2007:		
U.S. Government interest (70% of \$600)	\$ 420	
Net rental income (70% of \$2,000)	<u>1,400</u>	
		\$ <u>1,820</u>
Net economic loss deduction in 2007		(\$10,500)

### Computation of 2007 Net Taxable Income

Net income for 2007		\$21,500
Add: Contributions		<u>1,000</u>
Total		\$22,500
Less total nonapportionable income:		
Net rental income	\$2,000	
Loss on bonds sold	( 500)	
Net nonapportionable dividends	<u>1,000</u>	
		\$ <u>2,500</u>
Total apportionable income		\$20,000
Apportionable to North Carolina – 70%		14,000
Add nonapportionable income allocated directly to N C:		
Loss on bonds sold	(\$ 500)	
Net nonapportionable dividends	<u>1,000</u>	
		\$ <u>500</u>
Total allocated to North Carolina		\$14,500
Less: Net economic loss deduction from above		<u>( 10,500)</u>
Total		\$ 4,000
Less contributions to North Carolina donees:		
Amount subject to 5% limitation (5% of \$4,000)	\$200	
Amount given to N. C. educational institution	<u>500</u>	
		\$ <u>700</u>
Net taxable income in 2007		\$ 3,300

Example 3: Corporation Z, a Delaware corporation domesticated in North Carolina, is engaged in the business of manufacturing machinery within and without this State. Its commercial domicile is in New York. The corporation had a net loss of fifty-two thousand five hundred dollars (-\$52,500) in 2006 and net income of ninety-one thousand one hundred dollars (\$91,100) in 2007.

The arithmetical average of the apportionment factors of property, payrolls and sales was twenty percent (20%) in 2006 and twenty-five percent (25%) in 2007.

Listed below are income and deduction items included in the computation of net loss and net income.

- a. In each year, contributions of one thousand dollars (\$1,000) to donees outside North Carolina were deducted. In 2007 contributions of two hundred dollars (\$200) to North Carolina donees were also deducted.
- b. A loss of five hundred dollars (-\$500) was realized in each year on the sale of corporate bonds acquired and held as an investment. (Note: Since the losses were nonapportionable losses they are not included in apportionable income.)
- c. Nonapportionable interest of two thousand dollars (\$2,000) was received in each year on bonds acquired and held as an investment. (Note: Since this interest is nonapportionable income, it is not included in apportionable income.)
- d. Nonapportionable dividends of ten thousand dollars (\$10,000) (net nonapportionable dividend income) were received in each year from Corporation A. (Note: Although Corporation Z included the ten thousand dollars (\$10,000) in gross income, these dividends are nonapportionable income and as such are not included in apportionable income.)

### Computation of Net Economic Loss

Net loss for 2006		(\$52,000)
Add: Contributions		<u>1,000</u>
Total		(\$51,500)
Less total nonapportionable income:		
Loss on bonds sold	(\$ 500)	
Interest	2 000	
Net nonapportionable dividends	<u>10,000</u>	
		<u>\$11,500</u>
Total apportionable income (loss)		(\$63,000)
Apportionable to North Carolina – 20%		(\$12,600)
Reduced by income not taxable:		
Interest (20% of \$2,000)	\$ 400	
Net dividends (20% of \$10,000)	<u>2,000</u>	
		<u>2,400</u>
Net economic loss for 2006		\$10,200)

### Computation of Net Economic Loss Deduction

Net economic loss brought forward from 2006		\$10,200)
Reduced by nontaxable income received in 2007:		
Nonapportionable interest (25% of \$2,000)	\$ 500	
Net nonapportionable dividends (25% of \$10,000)	<u>2,500</u>	
		<u>\$ 3,000</u>
Net economic loss for 2007		(\$ 7,200)

### Computation of 2007 Net Taxable Income

Net income for 2007	\$91,100
Add: Contributions to donees located in N C	<u>200</u>
 Total	 \$91,300
Less total nonapportionable income:	
Loss on bonds sold	(\$ 500)
Interest	2,000
Net nonapportionable dividends	<u>10,000</u>
	<u>\$11,500</u>
 Total apportionable income	 \$79,800
 Apportionable to North Carolina – 25%	 \$19,950
Less: Net economic loss deduction from above	<u>( 7,200)</u>
 Total allocated to North Carolina	 \$12,750
Less: Contributions to donees located in North Carolina	<u>200</u>
 Net taxable income for 2007	 \$12,550

**N. Transactions Between Affiliated Corporations and Consolidated Returns (G.S. 105-130.5(a)(9), G.S. 105-130.6)**

**1. Preliminary Statement**

The law provides certain limitations and restrictions on deductions for payments or charges made in connection with transactions between a parent, subsidiary and affiliated corporation. The purpose of these provisions is to prevent a parent, subsidiary or affiliated corporation from reporting a distorted net income to North Carolina by siphoning off its income properly attributable to its operations in North Carolina to an out-of-state parent, subsidiary or affiliated corporation.

**2. Deductions for Payments and Charges Must Be Commensurate with Goods and Services Received**

In arriving at its state net income, a taxpayer corporation which is a parent, subsidiary or affiliate of another corporation or group of corporations is required to limit any deductions for payments to, or charges by, its parent, subsidiary or affiliated corporation to amounts which are reasonable in relation to the goods or services received therefor.

**3. Consolidated Returns**

Under State law, a corporation is not permitted to file a consolidated income tax return. However, in certain cases, the law does give the Secretary of Revenue authority to require the filing of a consolidated return.

If the Secretary finds that the net income reported by a parent, subsidiary or affiliated corporation does not represent the true earnings of such corporation on its business carried on in this State, the Secretary may require that such corporation file a consolidated return covering the entire operations of the parent and all subsidiary and affiliated corporations which had transactions with the corporation required to file a return in this state. The Secretary shall then determine the true amount of net income earned by the taxpayer in this State.

The combined net income of the parent and all subsidiary and affiliated corporations which had transactions with the corporation required to file a return in this state shall be apportioned to North Carolina by use of the applicable apportionment formula required to be used by the taxpayer under G.S. 105-130.4. In such cases there shall be included in the apportionment formula the property, payrolls and sales of all corporations for which the consolidated return is made.

If the Secretary finds that the determination of the net income of a parent, subsidiary or affiliated corporation under a consolidated return will produce a greater or lesser figure than the amount of income actually earned in the State, the Secretary may readjust the determination by reasonable methods of computation to make it conform to the amount of income earned in North Carolina. If the corporation disagrees with the Secretary's determination, it may, within thirty (30) days after notice of such determination, submit its objections and an alternative method of determination. The Secretary will consider the alternative method proposed in arriving at a conclusive determination.

#### **4. Subsidiary and Affiliated Corporations Required to Furnish Information Requested by Secretary**

The law provides that a parent, subsidiary or affiliated corporation must report, in its income tax return or otherwise, any information the Secretary "may reasonably require for the determination of the net income taxable under this division."

#### **5. Definitions of Subsidiary Corporation, Parent Corporation, and Affiliated Corporation**

For the purpose of the provisions of G.S. 105-130.6, a "subsidiary corporation" is a corporation that is controlled either directly or indirectly by another corporation by stock ownership, interlocking directors, or by any other means whatsoever exercised by the same or associated financial interests, whether such control is direct or through one or more subsidiary, affiliated or controlled corporations. A "parent corporation" is a corporation that by any of the foregoing means controls another corporation. An "affiliated corporation" is a member of a group of corporations which are controlled directly or indirectly by the same parent corporation or by the same or associated financial interest by stock ownership, interlocking directors, or by any other means whatsoever, regardless of whether such control is through one or more subsidiary, affiliated, or controlled corporations.

## **6. Transactions Between Affiliated Corporations Closely Examined by the Department**

When examining and auditing corporate income tax returns, the Department's auditors give special attention to income and expense items resulting from transactions between affiliated corporations in order to determine whether the taxpayers have complied with the provisions of G.S. 105-130.6 in reporting their net income.

## **O. Partnership and the Corporate Partner (17 NCAC 05C.1700)**

### **1. Reporting Partnership Net Income**

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

### **2. Apportionable Income or Nonapportionable Income**

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

## **P. Filing of Returns and Payment of Taxes**

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

General business corporation franchise and income tax returns are due on the 15<sup>th</sup> day of the third month following the close of the income year and are filed on a combination return form. Effective for taxable years beginning on or after January 1, 2008, the general business corporation franchise and income tax returns are due on the 15<sup>th</sup> day of the fourth month following the close of the corporation's income year. A short period return required as a result of a corporation becoming a member of a consolidated group for federal purposes may be filed on the due date of the federal short period return. However, interest is due beginning seventy-five (75) days following the last day of the short period.

A foreign corporation that files a federal income tax return pursuant to IRC §6072(c) is required to file its return on or before the 15<sup>th</sup> day of the sixth month following the close of its income year.

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

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

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

Example 1: The short tax period for Corporation X ends on May 14. The short period return and tax payment are due on July 15 (seventy-five (75) days after April 30.) On July 15, Corporation X may apply for an extension of time to file the short period return; however, to avoid penalty and interest, one hundred percent (100%) of the tax due must be paid by July 15.

Example 2: The short tax period for Corporation Y ends on May 16. The short period return and tax payment are due on August 15 (seventy-five (75) days after May 31). On August 15, Corporation Y may apply for an extension of time to file the short period return; however, to avoid penalty and interest, one hundred percent (100%) of the tax due must be paid by August 15.

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

## **2. Extension of Filing Date**

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

For additional detailed information concerning the requirements for obtaining an extension of time for filing a corporate franchise and income tax return, see Subject, "Extension of Time for Filing Return."

## **3. Payment of Taxes**

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

## **4. Interest and Penalties (17 NCAC 05C.2003)**

Interest accrues at the rate established pursuant to G.S. 105-241.21 on any tax paid after the date set by statute for filing the return. The statutory due date for filing a corporation franchise and income tax return is the fifteenth day of the third month following the close of the corporation's income year (effective for taxable years beginning on or after January 1, 2008, the fifteenth day of the fourth month). A

failure to file penalty of five percent (5%) of the total taxes due is incurred each month a return is delinquent with the minimum penalty being five dollars (\$5) and the maximum penalty being twenty-five percent (25%). In addition the corporation is subject to the failure to pay by the due date penalty of ten percent (10%).

#### **5. Income Tax Refunds to Wildlife Fund**

A corporation entitled to a refund of income taxes paid may elect to contribute all or any part of such refund to the Wildlife Fund for the support of wildlife management and protection programs administered by the Wildlife Resources Commission.

#### **6. Overpayment Credited To Next Year's Tax**

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

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

#### **7. Protective Refund Claim**

A taxpayer can file a protective refund claim to protect his/her right to a potential refund of corporate income or franchise tax based on a contingent event for a taxable period for which the statute of limitations is about to expire. A protective claim is usually based on contingencies such as pending litigation or an ongoing tax audit in another state.

The Department of Revenue will accept a protective claim for refund if

- it is filed before the expiration of the statutory refund claim period;
- it identifies and describes the contingencies affecting the claim;
- it is sufficiently clear and definite to alert the Department of Revenue as to the essential nature of the claim; and
- it identifies the tax schedule and the specific year for which the protective claim is filed.

There is no special form for filing a protective claim. The Department of Revenue will accept any written submission if it meets all the required elements. Upon conclusion of the contingency, a taxpayer may finalize the claim for refund by filing an amended return for the tax year at issue.

It is not necessary for a taxpayer to file a protective refund claim for a year under examination by the Internal Revenue Service if the protective refund claim is based on a contingent event related to the federal examination since, under North Carolina law, a taxpayer has six months after being notified of the federal changes to file an amended return to report the changes.

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

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

An extension of time to file the franchise and income tax return may be granted for seven (7) months providing an extension application is timely filed. (Effective for taxable years beginning on or after January 1, 2008, the extension will be granted for six (6) months.)

**2. Form to be Used**

Form CD-419 is the application for extension form that must be filed before an extension of time to file the return can be granted. The form must be filed with the Department on or before the fifteenth day of the third month following the close of the income year. (Effective for taxable years beginning on or after January 1, 2008, the fifteenth day of the fourth month.)

**3. Payment Due**

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

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

**1. Dissolutions (17 NCAC 05C.2101)**

**a. Voluntary Dissolution**

A corporation is dissolved immediately upon the effective date of filing the articles of dissolution with the Secretary of State. Although a tax clearance is no longer a part of the Secretary of State's voluntary dissolution process, this in no way relieves the corporation of its liability to file all tax reports and returns due and pay all taxes due the Department of Revenue. The Department will continue to notify a corporation of any unfulfilled tax requirements.

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

**b. Administrative Dissolution**

The Secretary of State may administratively dissolve corporations for various non-compliance reasons. Once this dissolution occurs, the corporation may apply to the Secretary of State for reinstatement. The administrative dissolution in no way relieves the corporation of its liability to file all reports and returns due and pay all taxes due the Department.

## **2. Withdrawals**

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

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

## **S. Suspensions and Reinstatements**

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

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

### **2. Reinstatement of Corporate Charter**

A domestic corporation (incorporated in North Carolina) certified for suspension of its Corporate Charter to the Secretary of State’s office with an effective “suspended” date on or after July 2, 1985 may be reinstated without regard to the elapsed suspension period provided all returns are filed with remittance of the tax, interest and penalty due, plus the reinstatement fee of twenty-five dollars (\$25.00).

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

## **T. Exempt Corporations (G.S. 105-125, G.S. 105-130.11, G.S. 105-130.12)**

### **1. Preliminary Statement**

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

## **2. Corporations Fully Exempt**

These corporations qualify for the full income tax exemption:

- Insurance companies subject to the tax on gross premiums are exempt from income tax.
- Telephone membership corporations organized under Chapter 117 of the General Statutes of North Carolina are exempt from income tax. Electric membership corporations are also exempt for income taxes.

## **3. Corporations Conditionally or Partially Exempt**

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

- a. Fraternal societies, orders or associations. To qualify for income tax exemption, the organization must (1) operate under the lodge system or for the exclusive benefit of members of a fraternity that is operating under the lodge system; and (2) provide life, sick, accident or other benefits to the members or their dependents.
- b. Corporations organized or trusts created for religious, charitable, scientific or educational purposes, including cemetery corporations and organizations for the prevention of cruelty to children and animals.
- c. Business leagues, chambers of commerce, merchants associations and boards of trade.
- d. Civic leagues or organizations operated exclusively for the promotion of civic welfare.
- e. Clubs organized and operated exclusively for pleasure, recreation and other non-profit purposes.
- f. Mutual hail, cyclone and fire insurance companies; mutual ditch, irrigation, canning and breeding associations; mutual or cooperative telephone companies; and like organizations of a purely local character which derive their entire income from assessments, dues or fees collected from members for the sole purpose of meeting expenses.
- g. Farmers' marketing associations operating as sales agents to market the products of members or other farmers, and to return to them the proceeds, less the necessary selling expenses, on the basis of the quantity of product furnished by them.

- h. Pension, profit-sharing, stock bonus and annuity trusts established by employers for the purpose of distributing both the principal and income thereof exclusively to eligible employees or the beneficiaries of such employees. There must be no discrimination in favor of any particular employee. The interest of individual employees must be irrevocable and nonforfeitable to the extent of contributions by such employees. Exemption of a trust under the Federal income tax law is a prima facie basis for granting exemption from North Carolina franchise and income taxation.
- i. Condominium associations, homeowner associations or cooperative housing corporations not organized for profit.
- k. Cooperative or mutual associations formed under Section 54-124 of the General Statutes to conduct agricultural business on the mutual plan, and marketing associations formed under Section 54-129 of the General Statutes are required to file an annual income tax return on Form CD-418 and to pay tax on any net income not refunded on a patronage basis on or before the 15<sup>th</sup> day of the ninth month after close of the income year. They are also required to furnish with this return the names and addresses of all persons paid a patronage refund of ten dollars (\$10.00) or more, and the amount of the refund paid to each.
- l. North Carolina political organizations are exempt from franchise tax, but must file a corporate income tax return if the organization has gross taxable income of more than one hundred dollars (\$100). Organizations must first complete federal Form 1120-POL to determine the organization's federal taxable income. The political organization may attach a copy of its federal return instead of completing Schedule G of Form CD-405. If North Carolina adjustments are applicable, Schedule H must also be completed.

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

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

The non-profit organizations and cooperative and mutual associations listed above are not exempt from tax on income received in excess of one thousand dollars (\$1,000) annually from business activities not substantially related to the functions for which the organizations or associations were formed. However, they are fully exempt from tax on the following income unless such income is classified as unrelated business taxable income under the Code: Interest, royalties, dividends and rentals; income from a business operated without cost to the organization; income from the sale of merchandise donated to the organization; income from a business conducted by a

religious, charitable, scientific, or educational organization for the convenience of its members; income derived from research performed by a college, university or hospital, or performed for a governmental unit or agency, or performed by a research organization primarily for the benefit of the public, unless such income is deemed to be related income by the IRS.

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

#### **5. Regulated Investment Companies and Real Estate Investment Trusts**

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

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

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

#### **6. Real Estate Mortgage Investment Conduits (REMIC)**

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

#### **7. Limited Liability Company (LLC)**

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

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

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

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

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

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

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

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

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

## **8. Proof of Exemption**

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

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

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

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

#### **9. Notification of Change In Purposes or Operations**

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

### **U. Reporting Federal Changes (G.S. 105-130.20, G.S. 105-241.10)**

#### **1. Requirement for Reporting Changes**

If the amount of taxable income of any corporation subject to tax in this State, as reported or reportable to the United States Treasury Department, is changed by the U.S. Government, such corporation must file a return under oath reflecting such change within six months after receipt of the Federal report.

#### **2. Assessments or Refunds**

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

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

If there is a federal determination and the taxpayer does not file the required return to report the federal changes, an assessment of tax must be proposed within three years from the date of the receipt by the Department of Revenue of the final report of federal determination from the U.S. government.

**3. Extent of Changes That May Be Made**

When the Department of Revenue receives a timely amended return or report reflecting changes made in the net income of a corporation, the Secretary may assess tax or additional tax based on the federal changes and may also make any other adjustments that are related to the federal changes. If the taxpayer does not timely report the federal changes, the Department may also make any other changes based on any facts or evidence brought to his attention or shall otherwise acquire, whether or not such facts or evidence were considered by the federal government. This is the case regardless of whether or not an adjustment has been made previously for the taxable year affected by the federal changes.

**4. Fraud Provisions on Federal Changes**

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

**V. Domestic International Sales Corporation (G.S. 105-130.3, G.S. 105-130.4, G.S. 105-262)**

**1. Doing Business Activities of DISC (17 NCAC 05C.2400)**

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

**2. Determination of DISC Net Income**

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

**3. Apportionment of DISC Net Income**

The net income of a DISC subject to a tax measured by net income both within and without this State shall be apportioned to this State by use of the applicable apportionment formula set out in G.S. 105-130.4. The ratio determined thereunder

for apportioning the net income of the DISC shall be computed by including the property, payroll and sales of the parent corporation in the respective factors of the DISC. Where the DISC conducts substantial business with a supplier(s) other than its parent, the property, payroll and sales of the supplier(s) may be included in the respective factors of the DISC to the extent prescribed by the Secretary of Revenue. The property, payroll and sales of the parent corporation or other supplier(s) included in the factors of the DISC shall be for the period ending with or within the income year of the DISC. Further, the Secretary of Revenue may prescribe such other method or methods as may be deemed necessary to attribute to this State a fair and reasonable profit that would normally arise from the operation of such businesses conducted on a true arms-length basis.

**W. S Corporations (G.S. 105-131)**

**1. Corporations Required to File**

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

**2. Forms to be Used for Filing**

S corporations doing business in North Carolina use Form CD-401S to report activities.

**3. Return and Payment Due**

The due date of the S return is the 15<sup>th</sup> day of the third month (effective for taxable years beginning on or after January 1, 2008, the fourth month) following the close of the income year. The liability for franchise tax is payable on the statutory due date of the return, without regard to extension. Any income tax payment made on behalf of nonresident shareholders included in a composite return is also due at that time.

**4. Extensions**

An extension of time to file the S corporation's franchise and income tax return will be granted for seven (7) months (effective for taxable years beginning on or after January 1, 2008, six (6) months) provided the application is timely filed.

**5. Election**

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

**6. Nonresident Shareholder Agreement (Form NC-NA)**

An S corporation with nonresident shareholders is required to submit with the first North Carolina S return an agreement for each nonresident shareholder. The

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

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

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

S corporations determine their franchise tax liability in the same manner as all other general business corporations. Franchise tax schedules A, C, D and E pertain to the corporation franchise tax base and the amount of tax liability. There is no difference between an S corporation and a C corporation with respect to the franchise tax requirement, liability, etc. Although some of the “net worth” accounts are different due to the labels placed on certain accounts, the fundamental concept of determining the taxable values from the corporation’s assets less definite legal liabilities will prevail for all corporations subject to the “general business” franchise tax.

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

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

The S corporation’s income and expenses are divided among and passed through to its shareholders, who then must report the income and expenses on their State individual or trust tax returns. The pro rata share of resident and nonresident shareholders in the income and expenses of an S Corporation is subject to the adjustments under individual income tax law (G.S. 105-134.6).

**9. Composite Return for Nonresident Shareholders (G.S. 105-131.7(b))**

If the S corporation has shareholders who are nonresidents of North Carolina, the corporation may file a composite return that reflects the state taxable income of each nonresident and the amount of tax due. The composite return is available for nonresident shareholders only. A remittance of the total tax due on behalf of nonresident shareholders is made with the return, CD-401S, when filed.

A nonresident individual shareholder is not required to file a North Carolina individual income tax return if the only income in North Carolina is reported by the S corporation. A nonresident trust shareholder, other than a grantor trust, is required to file a North Carolina fiduciary income tax return even if its only income in North Carolina is reported by the S Corporation.

## **10. Computation of Net Income on Composite Returns**

The computation of net income on a composite return is basically the same as for C corporations; i.e., all income subject to tax and all allowable deductions permitted under the Code will be considered.

## **X. Qualified Subchapter S Subsidiaries**

### **1. Preliminary Statement**

The Federal Small Business Job Protection Act of 1996 allows S corporations to own qualified S corporation subsidiaries, (QSSS). The parent must elect qualified S corporation treatment for its one hundred percent (100%) owned subsidiary. For federal tax purposes, a QSSS is not treated as a separate corporation, but rather all the subsidiary's assets, liabilities, and items of income, deductions and credits are treated as those of the S corporation parent. (IRC Section 1361(b)(3)(A)). North Carolina follows the federal treatment for income tax purposes and recognizes all the income and expense items as belonging to the parent corporation. (Reference: North Carolina Technical Advice Memorandum dated August 1, 1997, Qualified Subchapter S Subsidiaries, (CTAM 97-13)).

### **2. Parent S Corporation Nexus**

All of the subsidiary's activities will be attributed to the parent for purposes of determining whether the parent is doing business in North Carolina.

### **3. Apportionment Factors**

The parent S corporation must aggregate and include the subsidiary's items of income, loss, and deductions before determining the parent's apportionable or allocable income. The parent S corporation must also include the subsidiary's property, payroll and sales in calculating its apportionment factors. The parent S corporation must use the same apportionment factor that was used to apportion the combined income of the parent and subsidiaries to determine its capital stock, surplus and undivided profits franchise tax base. The QSSS does not calculate an apportionment factor for income tax since its income is taxed at the parent level. However, it must calculate its apportionment factor using its own property, payroll, and sales to determine its capital stock, surplus and undivided profits franchise tax base.

### **4. Franchise Tax Returns**

Each QSSS doing business in this State and each parent S corporation doing business in this State must file a separate franchise tax return for each taxable period based on their own separate attributes. The assets, liabilities, income, deductions or credits of the parent and the qualified S corporation are not combined for this purpose. A franchise tax return must be filed even if the resulting liability is the minimum franchise tax.

### **5. Shareholders**

Shareholders in an S corporation parent with a QSSS doing business in this State must report income attributable to this State in accordance with Part 1A of Article 4 of Chapter 105 of the General Statutes.

**III. TAX CREDITS**  
**(Articles 3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H, 3J, 3K and 4)**

**A. General Tax Credits**

**1. General Information**

**a. Franchise, Income, or Gross Premium Tax Election**

The general tax credits allowed in Chapter 105 may be taken against corporate income tax only unless otherwise stated.

**b. Forms**

Form CD-425 is used to report credits that are not limited to fifty percent (50%) of the tax. The Form NC-478 series is used to calculate and report tax credits that are limited to fifty percent (50%) of the taxpayer's tax less the sum of all other credits that the taxpayer claims. Forms NC-478A through NC-478L are used to calculate the specific credits without regard to the fifty percent (50%) limitation. Form NC-478 is used to total the specific credits, to determine if the fifty percent (50%) limitation applies, and, if so, to allocate the limited total credit among the specific credits.

Form CD-425 and, if applicable, both Form NC-478 and the applicable Form NC-478 series form must be filed for any taxable year in which the taxpayer is eligible to claim a credit or 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. Credit for Dwelling Units for Handicapped Persons (G.S. 105-130.22)**

**a. Credit**

Corporate owners of multifamily rental units located in North Carolina are allowed an income tax credit for each dwelling unit for physically handicapped persons constructed during the income year, subject to the limitations set out below.

The allowable credit is five hundred fifty dollars (\$550) for each dwelling unit that qualifies for use by physically handicapped persons. However, credit is allowed only for the number of such dwelling units completed during the income year that were constructed and required to be built in compliance with Volume I-C of the North Carolina Building Code.

No adjustment is required to be made to the depreciable cost of the unit on account of the allowable credit.

**b. Carryforward**

If the allowable income tax credit exceeds the taxpayer's income tax liability reduced by all other credits allowed against North Carolina income tax, the excess may be carried forward and claimed by such taxpayer in the next succeeding year only.

**c. Eligibility**

To qualify for the credit, the units must meet the requirements of Volume I-C of the North Carolina Building Code. Volume I-C is administered by the Building Accessibility Section of the North Carolina Department of Insurance and contains provisions and standards for making buildings and facilities accessible to and usable by physically handicapped persons. This section applies to all buildings and facilities regulated by the North Carolina State Building Code, with the exception of single and two-family dwellings.

**d. Substantiation**

The corporation must include with the tax return a copy of the occupancy permit on which the building inspector must record the number of qualified units completed during the income year.

**3. Credit for Construction of Cogenerating Power Plant (G.S. 105-130.25)**

**a. Credit**

A corporation or partnership, other than a public utility as defined in G.S. 62-3(23), that constructs a cogenerating power plant is allowed a credit for a portion of the cost to purchase and install the electrical or mechanical power generation equipment of that plant. To be eligible for the credit, the corporation or partnership must own or control the power plant at the time of construction.

The allowable credit is equal to ten percent (10%) of the cost paid during the tax year in which the credit is claimed for the purchase and installation of the electrical or mechanical power generation equipment of a cogenerating power plant. The credit may not be taken for the year in which the costs are paid but shall be taken for the taxable year beginning during the calendar year following the calendar year in which the costs are paid.

**b. Cogenerating Power Plant Defined**

A cogenerating power plant is a power plant that sequentially produces electrical or mechanical power and useful thermal energy using natural gas as its primary energy source. A plant whose combustion equipment uses residual oil, middle distillate oil, gasoline, or liquid propane gas (LPG) as a primary fuel will not qualify for the credit.

**c. Alternative Method**

An eligible taxpayer may elect to treat the costs paid during an earlier year as if they were paid during the year the plant becomes operational. Once made, the election is irrevocable. An election with respect to costs paid by a partnership must be made by the partnership and is binding on any partners to whom the credit is passed through.

If a taxpayer makes this election, the credit may not exceed twenty-five percent (25%) of the amount of tax for the year reduced by the sum of all credits allowed,

except payments of tax by or on behalf of the taxpayer. Any unused portion of the credit may be carried forward for the next ten (10) taxable years.

**d. Application**

An application is required to be filed with the Secretary on or before April 15 following the calendar year in which the costs were paid without regard to the method elected by the taxpayer. Under either method, the taxpayer applies for the total credit for the first year eligible.

**e. Ceiling**

The total amount of all tax credits allowed for payments for construction and installation made in a calendar year may not exceed five million dollars (\$5,000,000). If the total amount of credits for eligible payments applied for by all taxpayers exceeds five million dollars (\$5,000,000), in any one calendar year, the maximum allowable credit will be prorated among all applicants proportionally. If the taxpayer's eligible credit is reduced because of the ceiling, the reduction may be carried forward for the next ten taxable years. The taxpayer must reapply each year for the unused credits.

**4. Credit for Real Property Donated for Conservation Purposes (G.S. 105-130.34)**

**a. Credit**

Any C corporation that makes a qualified donation of an interest in real property located in North Carolina during the taxable year is allowed a credit against its corporate income tax. The credit is twenty-five percent (25%) of the fair market value of the property interest donated, not to exceed five hundred thousand dollars (\$500,000).

**b. Eligible Property Interest**

To be eligible for this credit the donated interest in real property must be useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, forestland or farmland conservation, watershed protection, conservation of natural areas, conservation of natural or scenic river areas, conservation of predominately natural parkland, or historic land conservation, and the interest in real property must be donated in perpetuity to and accepted by the State, a local government, or a body that is both organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions pursuant to G.S. 105-130.9.

Lands required to be dedicated pursuant to local government regulation or ordinance and dedications made to increase building density levels permitted under a regulation or ordinance are not eligible for this credit.

**c. Substantiation**

The taxpayer must file with its income tax return for the taxable year in which the credit is claimed, a certification by the Department of Environment and Natural Resources that the property donated is suitable for one or more of the valid public

benefits set forth in this subsection, and a self-contained appraisal report or summary appraisal report. For fee simple absolute donations of real property, the taxpayer may provide documentation of the county's appraised value of the property, as adjusted by the sales assessment ratio, in lieu of an appraisal report.

**d. Carryforward**

If the allowable income tax credit exceeds the taxpayer's tax liability reduced by all other credits allowed against North Carolina income tax, the excess may be carried forward and deducted in the next five succeeding years.

**e. Limitations**

The portion of the fair market value of the property used to calculate the allowable tax credit is not allowed as a charitable contribution deduction.

**5. Credit for Conservation Tillage Equipment (G.S. 105-130.36)**

**a. Credit**

A corporation that purchases conservation tillage equipment for use in a farming business, including tree farming, shall be allowed an income tax credit equal to twenty-five percent (25%) of the cost of the equipment paid during the taxable year.

**b. Conservation Tillage Equipment Defined**

Conservation tillage equipment means planters such as those commonly known as "no-till" planters designed to minimize disturbance of the soil in planting crops or trees, including equipment that may be attached to equipment already owned by the taxpayer. The term also means equipment designed to minimize disturbance of the soil in reforestation site preparation. The inclusion of reforestation equipment that may be attached to equipment already owned by the taxpayer is limited to those items of equipment generally known as "KG-Blades", "drum-choppers", or "V-Blades".

**c. Cap on Credit**

This credit may not exceed two thousand five hundred dollars (\$2,500) for any taxable year of any taxpayer.

**d. Restrictions**

The credit may only be claimed by the first purchaser of the equipment and may not be claimed by a corporation that purchases the equipment for resale or for use outside this State.

**e. Carryforward**

If the credit exceeds the taxpayer's income tax liability, the excess may be carried over and claimed in the next five (5) succeeding years.

**f. Basis Reduction**

The basis in any equipment for which a credit is allowed under this section shall be reduced by such credit.

## **6. Credit for Gleaned Crop (G.S. 105-130.37)**

### **a. Credit**

A corporation that grows a crop and permits the gleaning of the crop is allowed an income tax credit equal to ten percent (10%) of the market price of the quantity of the gleaned crop.

### **b. Definitions**

These definitions apply:

#### **i. Gleaning**

The harvesting of a crop that has been donated by the grower to the nonprofit organization that will distribute the crop to individuals or other nonprofit organizations it considers appropriate recipients of the food.

#### **ii. Market price**

The season average price of the crop as determined by the North Carolina Crop and Livestock Reporting Service in the Department of Agriculture and Consumer Services, or the average price of the crop in the nearest local market for the month in which the crop is gleaned if the Crop and Livestock Reporting Service does not determine the season average price for that crop.

#### **iii. Nonprofit organization**

An organization to which charitable contributions are deductible under the Code.

### **c. Cap on Credit**

The allowable credit cannot exceed the taxpayer's tax liability.

### **d. Carryforward**

Any unused portion of the credit may be carried forward for the succeeding five (5) years.

### **e. Restrictions**

A charitable contribution deduction is not allowed under G.S. 105-130.5(b)(5) for any items for which this credit is claimed.

## **7. Credit for Certain Telephone Subscriber Line Charges (G.S. 105-130.39)**

### **a. Credit**

A corporation that provides local telephone services to low income residential customers at reduced rates is allowed a credit equal to the difference between the amount of receipts the corporation would have received from those low-income customers had the regular rates been charged and the amount billed to those low income customers.

### **b. Restrictions**

The credit is allowed only for a reduction in local telephone service rates and fees. No credit is allowed for any reduction in interstate subscriber line charges.

**c. Cap on Credit**

The credit may not exceed the amount of corporate income tax for the taxable year reduced by the sum of all credits allowable, except tax payments made by or on behalf of the corporation.

**8. Credit for Use of North Carolina Ports (G.S. 105-130.41)**

**a. Credit**

An income tax credit is available to a corporation whose waterborne cargo is loaded onto or unloaded from an ocean carrier calling at the North Carolina ports of Wilmington or Morehead City. The credit is allowed against corporate income tax in an amount equal to the excess of the wharfage, handling (in or out) and throughput charges assessed on the cargo for the current taxable year over an amount equal to the average of the charges for the current taxable year and the two preceding taxable years. For purposes of this section, the terms “handling” (in and out) and “wharfage” have the meanings provided in the State Ports Tariff Publications, “Wilmington Tariff, Terminal Tariff #6,” and “Morehead City Tariff, Terminal Tariff #1” and the term “throughput” has the same meaning as “wharfage” but applies only to bulk products, both dry and liquid. The credit sunsets for taxable years beginning on or after January 1, 2009.

**b. Limitations and Carryforward**

The amount of credit is limited to fifty percent (50%) of the income tax liability for the taxable year reduced by the sum of all credits allowable. Any unused portion of the credit may be carried forward and applied to the income tax liability for the five succeeding years. The maximum cumulative credit that may be claimed by a corporation is two million dollars (\$2,000,000).

**c. Substantiation**

To obtain the credit, the taxpayer must provide a statement from the State Ports Authority certifying the amount of charges paid on which the credit is based.

**9. Credit for Supervisory Fees Paid by Savings and Loan Associations (G.S. 105-130.43)**

**a. Credit**

Savings and loan associations are allowed an income tax credit equal to the amount of supervisory fees paid to the savings and loan division of the Department of Commerce.

**b. Cap on Credit**

The credit claimed may not exceed the amount of corporate income tax, reduced by the sum of all credits allowed against the tax, except tax payments made by or on behalf of the taxpayer.

**c. Restrictions**

These fees cannot be deducted in determining taxable income if they are claimed as an income tax credit.

**10. Credit for Poultry Composting Facility (G.S. 105-130.44)**

**a. Credit**

An income tax credit is available to corporations for constructing a poultry composting facility in North Carolina for the composting of poultry carcasses from commercial poultry operations. The credit is equal to twenty-five percent (25%) of the installation, materials and equipment costs of construction paid during the taxable year. The credit allowed does not apply to costs paid with funds provided by a State or federal agency.

**b. Limitations and Carryforward**

The credit may not exceed one thousand dollars (\$1,000) for any single installation. The credit may not exceed the amount of tax for the taxable year reduced by the sum of all tax credits allowable, except payments of tax by or on behalf of the taxpayer. Any unused portions of the credit may not be carried forward.

**11. Credit for Manufacturing Cigarettes for Exportation (G.S. 105-130.45)**

**a. Credit**

An income tax credit is allowed to a corporation engaged in the business of manufacturing cigarettes in the United States for exportation to a foreign country, a possession of the United States, and a commonwealth of the United States that is not a state. A corporation must waterborne export cigarettes and other tobacco products through the North Carolina State Ports during the taxable year to qualify for the credit. However, the calculation of the credit is not limited to just cigarettes that are waterborne exported. The amount of credit available is based on the current year's exportation volume compared to the base year's exportation volume. In the case of a successor in business, the amount of credit allowed under this section is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume, rounded to the nearest whole percentage. The amount of credit may not exceed six million dollars (\$6,000,000) and is computed as follows:

<u>Current Yr.'s Exportation Volume Compared to its Base Yr.'s Exportation Volume</u>	<u>Amount of Credit per 1000 Cigarettes Exported</u>
120% or more	40 cents
119% - 100%	35 cents
99% - 80%	30 cents
79% - 60%	25 cents
59% - 50%	20 cents
Less than 50%	None

**b. Substantiation**

A corporation that claims this credit must include these items with its tax return:

- A statement of the base year exportation volume. The base year is calendar year 2003.

- A statement of the exportation volume on which the credit is based.
- A list of the corporation's export volumes as shown on its monthly reports to the Alcohol and Tobacco Tax and Trade Bureau of the United States Treasury for the months in the tax year for which the credit is claimed.

**c. Limitations and Carryforward**

The maximum eligible credit for cigarettes exported during the taxable year is the lesser of six million dollars (\$6,000,000) or fifty percent (50%) of the amount of income tax liability for the taxable year reduced by the sum of all other credits. Any unused credit for cigarettes exported may be carried forward for the next succeeding ten (10) years.

**d. No Double Credit**

A taxpayer may not claim this credit and the credit allowed under G.S. 105-130.46 for the same activity.

**e. Sunset**

This credit is repealed effective for cigarettes exported on or after January 1, 2018.

**12. Credit for Manufacturing Cigarettes for Exportation While Increasing Employment and Utilizing State Ports (G.S. 105-130.46)**

**a. Credit**

A corporation engaged in the business of manufacturing cigarettes for exportation that satisfies the employment level requirement for this credit and exports cigarettes and other tobacco products through the North Carolina State Ports during the taxable year is allowed a credit for manufacturing cigarettes for exportation while increasing employment and utilizing State Ports. The amount of the credit is equal to forty cents (40¢) per one thousand cigarettes exported, however, the amount of credit earned during the taxable year may not exceed ten million dollars (\$10,000,000).

**b. Definitions**

The following definitions apply:

**i. Employment level**

The total number of full-time jobs and part-time jobs converted into full-time equivalences.

**ii. Exportation**

The shipment of cigarettes manufactured in the United States to a foreign country sufficient to relieve the cigarettes in the shipment of the federal excise tax on cigarettes.

**iii. Full-time job**

A position that requires at least one thousand six hundred (1,600) hours of work per year and is intended to be held by one employee during the entire year.

**iv. Successor in business**

A corporation that through amalgamation, acquisition, consolidation, merger or other legal succession becomes invested with the rights and assumes the burdens of the predecessor corporation and continues the cigarette exportation business.

**c. Employment Level**

The corporation must maintain an employment level in this State that exceeds the corporation's employment level in the State at the end of the 2004 calendar year by at least eight hundred (800) full-time jobs. A job is located in this State if more than fifty percent (50%) of the employee's duties are performed in this State.

**d. Reduction of Credit**

A corporation that has previously satisfied the qualification requirements for this credit but that fails to satisfy the employment level requirement in a succeeding year may still claim a partial credit for the year in which the employment level requirement is not satisfied. The partial credit allowed is equal to the credit that would otherwise be allowed multiplied by a fraction. The numerator of the fraction is the excess of the number of full-time jobs in this State over the corporation's employment level in this State at the end of the 2004 calendar year. The denominator of the fraction is eight hundred (800). In the case of a successor business, the numerator of the fraction is the number of full-time jobs by which the corporation's employment level in this State exceeds all its predecessor corporations' combined employment levels in this State at the end of the 2004 calendar year.

**e. Tax Election**

The credit may be taken against either corporate income tax or franchise tax. When the taxpayer claims this credit, the taxpayer must elect the percentages of the credit claimed against corporate income tax and franchise tax, respectively. This election is binding for the year in which it is made and for any carryforwards. A taxpayer may elect a different allocation for each year in which the taxpayer qualifies for a credit.

**f. Ceiling**

The total amount of this credit calculated as described above may not exceed fifty percent (50%) of the tax against which the credit is taken reduced by the sum of all other credits allowed against that tax, except tax payments made by or on behalf of the taxpayer. This limitation applies to the cumulative amount of the credit allowed in any tax year, including carryforwards claimed for this credit or the credit allowed under G.S. 105-130.45 for previous years.

**g. Carryforward**

Any unused portion of the credit may be carried forward for the next succeeding ten (10) years. All carryforwards must be taken against the tax against which the credit was originally claimed. A successor in business may take the carryforwards of a predecessor corporation as if they were carryforwards of a credit allowed to the successor in business.

**h. Substantiation**

A corporation that claims this credit must include these items with its tax return:

- A statement of the exportation volume on which the credit is based.
- A list of the corporation's export volumes shown on its monthly reports to the Alcohol and Tobacco Tax and Trade Bureau of the United States Treasury for the months in the tax year for which the credit is claimed.
- Any other information required by the Department of Revenue.

**i. No Double Credit**

A taxpayer may not claim this credit and the credit allowed under G.S. 105-130.45 for the same activity.

**j. Reports**

Any corporation that claims this credit must submit an annual report by May 1 of each year to the Senate Finance Committee, the House of Representatives Finance Committee, the Senate Appropriations Committee, the House of Representatives Appropriations Committee, and the Fiscal Research Division of the General Assembly. The report must state the amount of credit earned by the corporation during the previous year, the amount of credit including carryforwards claimed by the corporation during the previous year, and the percentage of domestic leaf content in cigarettes produced by the corporation during the previous year.

**k. Sunset**

This credit expires for exports occurring on or after January 1, 2018.

**13. Credit for Qualifying Expenses of a Production Company (G.S. 105-130.47)**

**a. Credit**

A taxpayer that is a production company and has qualifying expenses of at least two hundred fifty thousand dollars (\$250,000) with respect to a production is allowed a credit against corporate income taxes. The credit is equal to fifteen percent (15%) of the production company's qualifying expenses. The credit is claimed for the taxable year in which the production activities are completed but includes all of the taxpayer's qualifying expenses incurred with respect to the production, including qualifying expenses incurred in earlier years. In the case of an episodic television series, an entire season of episodes is one production.

**b. Definitions**

These definitions apply:

**i. Qualifying Expenses**

The sum of the total amount spent in this State for the following by a production company in connection with a production, less the amount paid to a highly compensated individual:

- Goods and services leased or purchased. For goods with a purchase price of twenty-five thousand dollars (\$25,000) or more, the amount

included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.

- Compensation and wages on which withholding payments are remitted to the Department of Revenue under Article 4A of this Chapter.

**ii. Highly Compensated Individual**

An individual who receives compensation in excess of one million dollars (\$1,000,000) with respect to a single production. If an individual receives compensation in excess of one million dollars (\$1,000,000), none of the compensation is included in the production's qualifying expenses. A highly compensated individual is an individual who receives compensation in excess of one million dollars (\$1,000,000) for personal services with respect to a single production, regardless of whether the individual receives the compensation directly from the production company or indirectly from a personal service company or an employee leasing company and regardless of whether the compensation is considered wages or nonemployee compensation.

**iii. Production Company (G.S. 105-164.3)**

A person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. However, radio productions do not qualify for the credit (see subsection 14.i below).

**iv. Feature Film**

A movie that is made for initial distribution in theaters and that is over forty (40) minutes long.

**v. Live Sporting Event**

A scheduled sporting competition, game, or race that is not originated by a production company, but is originated solely by an amateur, collegiate, or professional organization, institution, or association for live or tape-delayed television or satellite broadcast. A live sporting event does not include commercial advertising, an episodic television series, a television pilot, a music video, a motion picture, or a documentary production where any sporting events are presented through archived historical footage or similar footage taken at least thirty (30) days before it is used.

**c. Qualifying Expenses for Compensation and Wages**

Compensation and wages paid to employees for services performed in North Carolina on which income tax withholding payments are remitted to the Department of Revenue are eligible for the tax credit regardless of whether paid to residents or non-residents. Payments for per diem, living allowances, and fringe benefits are eligible to the extent they are included in the recipient's taxable wages subject to federal income tax withholding. The amount paid to an individual through a personal services corporation or through an employee-leasing organization is considered compensation and is subject to the "highly compensated individual" limitations in calculating the allowable credit.

**d. Qualifying Expenses for Services**

Spending for services is eligible for the tax credit regardless of whether paid to residents or non-residents, as long as the services are performed in North Carolina. The amount paid to an individual through a personal services corporation or through an employee leasing organization is subject to the “highly compensated individual” limitation in calculating the allowable credit.

**e. Qualifying Expenses for Goods**

Spending for goods purchased or leased from a North Carolina business is eligible for the tax credit. This includes fuel, food, airline tickets and other goods if purchased or leased from a business located in North Carolina.

**f. Pass-through Entity**

Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for this credit does not allocate the credit among any of its owners. Instead, the pass-through entity is considered the taxpayer for purposes of claiming this credit. If a return filed by a pass-through entity indicates that the entity is paying tax on behalf of the owners of the entity, the credit allowed under this section does not affect the entity’s payment of tax on behalf of its owners and cannot be applied against that liability.

**g. Return**

The credit is claimed on Form NC-415 filed for the taxable year in which the production activities are completed. Processing of the credit cannot begin until after the income tax return for the taxable year in which the production activities are completed is filed. The taxpayer must satisfy any tax liability for the tax year in which the tax credit is claimed before the credit will be refunded.

**h. Credit Refundable**

If the credit allowed exceeds the amount of income tax for the taxable year reduced by the sum of all credits allowable, the excess is refundable to the taxpayer. The refundable excess is governed by the same provisions that govern the refund of an income tax overpayment by the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits.

**i. Limitations**

The amount of credit allowed under this section with respect to a production that is a feature film may not exceed seven million five hundred thousand dollars (\$7,500,000). There is no maximum credit for other types of productions. No credit is allowed under this section for any production that satisfies one of the following conditions:

- It is political advertising.
- It is a television production of a news program or live sporting event.
- It contains material that is obscene, as defined in G.S. 14-190.1.
- It is a radio production.

**j. Substantiation**

A taxpayer allowed a credit under this section must maintain and make available for inspection any information or records required by the Secretary of Revenue. The taxpayer has the burden of proving eligibility for a credit and the amount of the credit. The Secretary may consult with the North Carolina Film Office of the Department of Commerce and the regional film commissions in order to determine the amount of qualifying expenses.

**k. Sunset**

This credit is repealed for qualifying expenses occurring on or after January 1, 2010.

**14. Credit for Recycling Oyster Shells (G.S. 105-130.48)**

**a. Credit**

A taxpayer who donates oyster shells to the Division of Marine Fisheries of the Department of Environment and Natural Resources is eligible for a credit against corporate income tax. The credit is one dollar (\$1.00) per bushel of oyster shells donated.

**b. Limitation**

The credit allowed cannot exceed the amount of corporate income tax for the taxable year reduced by the sum of all credits allowable, except corporate income tax payments made by or on behalf of the taxpayer.

**c. Carryforward**

Any unused portion of this credit may be carried forward for the succeeding five (5) years. A successor in business may take the carryforwards of a predecessor corporation as if they were carryforwards of a credit allowed to the successor in business.

**d. No Double Benefit**

A taxpayer that claims this credit may not take a deduction for a contribution allowed under G.S. 105-130.5(b)(5) or G.S. 105-130.9.

**e. Substantiation**

A taxpayer that claims this credit must obtain and maintain with its records a certification by the Department of Environment and Natural Resources stating the number of bushels of oyster shells donated by the taxpayer.

**f. Sunset**

This credit is repealed for taxable years beginning on or after January 1, 2011.

**B. Tax Incentives for New and Expanding Businesses (Article 3A)**

Article 3A is generally repealed for activities that occur in taxable years beginning on or after January 1, 2007. Different sunsets apply to interstate air couriers (G.S. 105-129.2A(a1)), eligible major industries (G.S. 105-129.2A(a2)), certain

taxpayers located in development zones (G.S. 105-129.2A(a3), and taxpayers that signed a letter of commitment with the Department of Commerce by December 31, 2006 (G.S. 105-129.2A(a4). The guidelines in effect prior to January 1, 2008 are available at [http://www.dor.state.nc.us/taxes/corporate/Article3A\\_Guidelines06.pdf](http://www.dor.state.nc.us/taxes/corporate/Article3A_Guidelines06.pdf).

## **C. Business & Energy Tax Credits (Article 3B)**

### **1. General Information**

(Applies to all credits under this article unless otherwise noted.)

#### **a. Franchise, Income, or Gross Premium Tax Election (G.S. 105-129.17(a))**

The credits allowed under this article can be taken against franchise or income tax, but not against insurance gross premium tax unless otherwise noted. The taxpayer must elect the tax against which a credit will be claimed when filing the return on which the first installment of the credit is claimed. This election is binding. All future installments and carryforwards of a credit must be claimed against the same tax.

#### **b. Cap on Credit (G.S. 105-129.17(b))**

Total credits, including carryforwards, claimed under this article may not exceed fifty percent (50%) of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits, including carryforwards, against that tax, except tax payments made by or on behalf of the taxpayer.

#### **c. Credit Carryforward (G.S. 105-129.17(b))**

Unused portions of the credits may be carried forward for the succeeding five (5) years unless otherwise noted, but must be taken against the same tax as on the return on which the credit was first taken.

#### **d. Substantiation (G.S. 105-125.18)**

The burden of proving eligibility for any credit under this article rests upon the taxpayer. Every taxpayer claiming a credit under this article must maintain and make available for inspection by the Secretary of Revenue any records the Secretary considers necessary to determine and verify the amount of the credit to which the taxpayer is entitled. No credit may be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

### **2. Credit for Investing in Business Property (G.S. 105-129.16)**

#### **a. Credit**

This credit was effective for taxable years beginning January 1, 1996 or later, and applicable to property placed in service on or after August 1, 1996. The credit expired effective for business property placed in service on or after January 1, 2002. However, taxpayers can continue to claim carryforwards of unused installments of the credit.

#### **b. Expiration of Credit**

If business property is disposed of, taken out of service, or moved out of North Carolina prior to the end of the five-year period in which the credit is claimed, the

credit expires and a taxpayer may not take any remaining installment of the credit except for the portion of an installment that accrued in a previous year and had been carried forward. (G.S. 105-129.16(b))

### **3. Credit for Investing in Renewable Energy Property (G.S. 105-129.16A)**

#### **a. Credit**

A taxpayer that has constructed, purchased, or leased renewable energy property and places it in service during the taxable year is allowed a credit equal to thirty-five (35%) of the cost of the property. No credit is allowed to the extent the cost of the renewable energy property was provided by public funds.

If the taxpayer owns the property, the cost is determined in accordance with section 1012 of the Code and is subject to the limitation on cost provided in section 179 of the Code. If the property is leased, the cost is eight (8) times the net annual rental rate. The net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The sub-rentals are not deducted if they are business income for the taxpayer.

If the property serves a single-family dwelling, the credit is taken for the taxable year in which the property is placed in service. For all other property, the credit is taken in five (5) equal installments beginning with the year the property is placed in service.

#### **b. Cap on Credit (G.S. 105-129.16A(c))**

The maximum credit allowed for nonresidential property is two million five hundred thousand dollars (\$2,500,000) per installation. The credit ceilings for residential property are:

- One thousand four hundred dollars (\$1,400) per dwelling unit for solar energy equipment for domestic water heating, including a system that heats a pool.
- Three thousand five hundred dollars (\$3,500) per dwelling for solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating; and
- Ten thousand five hundred dollars (\$10,500) per installation for any other renewable energy property for residential purposes.

#### **c. Eligible Renewal Energy Property (G.S. 105-129.15)**

Any of the following machinery and equipment or real property is considered to be eligible renewable energy property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; commercial thermal or electrical generation. Effective for taxable years beginning on or after January 1, 2006 electrical generation is no longer restricted to using renewable energy crops or wood waste material. Biomass equipment includes

any equipment used for converting, conditioning and storing the liquid fuels, gas and electricity produced with biomass equipment.

- Hydroelectric generators located at existing dams or waterways and related devices for water supply and control and converting, conditioning, and storing the electricity generated.
- Solar energy equipment that uses solar radiation as a substitute for traditional energy for water heating, active space heating and cooling, passive heating, daylighting, generating electricity, distillation, desalination, detoxification, or the production of industrial or commercial process heat. Solar energy equipment includes any equipment used for collecting, storing, exchanging, conditioning, or converting solar energy to other useful forms of energy.
- Wind equipment required to capture and convert wind energy into electricity or mechanical power and related devices.

**d. Expiration of Credit (G.S. 105-129.16A(b))**

If the property is disposed of, taken out of service, or moved out of North Carolina during the five-year installment period, the credit expires and a taxpayer may not take any remaining installment of the credit except for the portion of an installment that accrued in a previous year and has been carried forward. No credit is allowed to the extent the cost of the renewable energy property was provided by public funds.

**e. Credit Availability (G.S. 105-129.16A(d))**

A taxpayer may not claim a credit for renewable energy property under Article 3B if the taxpayer is claiming any other credit allowed in Chapter 105 with respect to renewable energy property. A taxpayer may not take a credit for property the taxpayer leases from another unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to the property.

**4. Credit for Constructing Renewable Fuel Facilities (G.S. 105-129.16D)**

Either a dispensing credit or a production credit is allowed for the construction of renewable fuel facilities. Either credit is subject to the tax election and cap on credit amount provisions of G.S. 105-129.17, the substantiation requirements of G.S. 105-129.18, and the requirement in G.S. 105-129.19 that the Department report the credits claimed to the Revenue Laws Study Committee and to the Fiscal Research Division of the General Assembly.

**a. Renewable Fuel Defined (G.S. 105-129.15(8))**

Renewable fuel is either:

- Biodiesel as defined in G.S. 105-449.60
- Ethanol either unmixed or in mixtures with gasoline that are seventy percent (70%) or more ethanol by volume.

**b. Dispensing Credit (G.S. 105-129.16D(a))**

A taxpayer that constructs and installs and places in service in this State a qualified facility for dispensing renewable fuel is allowed a dispensing credit. A facility is

qualified if the equipment used to store or dispense renewable fuel is labeled for this purpose and is clearly identified as associated with renewable fuel.

The credit is equal to fifteen percent (15%) of the cost to the taxpayer of constructing and installing the part of the dispensing facility, including pumps, storage tanks, and related equipment, that is directly and exclusively used for dispensing or storing renewable fuel.

The tax credit is claimed in three equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the portion of a facility that is directly and exclusively used for dispensing or storing renewable fuel is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim any carryforwards of any prior years' installments.

**c. Production Credit (G.S. 105-129.16D(b))**

A taxpayer that constructs and places in service in this State a commercial facility for processing renewable fuel is allowed a production credit. The credit is equal to twenty-five percent (25%) of the cost to the taxpayer of constructing and equipping the facility. The tax credit is claimed in seven equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the facility is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim carryforwards of any prior years' installments.

**d. Alternative Production Credit (G.S. 105-129.16D(b1))**

A taxpayer that constructs and places in service in this State three or more commercial facilities for processing renewable fuel and invests a total amount of at least four hundred million dollars (\$400,000,000) in the facilities is allowed a credit equal to thirty-five percent (35%) of the cost of constructing and equipping the facilities in lieu of the production credit allowed in G.S. 105-129.16D(b). To claim the credit, the taxpayer must obtain a written determination from the Secretary of Commerce that the taxpayer is expected to invest, within a five-year period, a total amount of at least four hundred million dollars (\$400,000,000) in three or more facilities.

The credit is taken in seven equal annual installments beginning with the taxable year in which the first facility is placed in service. If, in any one of the years in which an installment of the credit is to be claimed, a facility with respect to which the credit is claimed is disposed of or taken out of service and the investment requirements are no longer satisfied, the credit expires and the taxpayer may take any remaining installment of the credit only to the extent allowed under G.S. 105-129.16D(b). The taxpayer may, however, take the portion of an installment of the alternative production credit that accrued in a previous year and was carried forward to the extent permitted under G.S. 105-129.17.

Notwithstanding the provisions of G.S. 105-129.17(a), a taxpayer may claim the alternative production credit against corporate income tax only.

**e. No Double Credit (G.S. 105-129.16D(c))**

A taxpayer cannot claim the credits allowed under G.S. 105-129.16D(b) and G.S. 105-129.16D(b1) with respect to the same facility. A taxpayer that claims any other tax credit allowed under Chapter 105 with respect to the costs of constructing and installing a renewable energy facility may not take the credits allowed in this section with respect to the same costs.

**f. Sunset (G.S. 105-129.16D(d))**

The credits allowed in this section sunset for facilities placed in service on or after January 1, 2011.

**5. Credit for Small Business Employee Health Insurance (G.S. 105-129.16E)**

A small business that provides health insurance for all its eligible employees is allowed a tax credit. For purposes of this credit, a taxpayer provides health benefits if it pays at least fifty percent (50%) of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125 or its employees have qualifying existing coverage.

**a. Amount of Credit**

The amount of credit per eligible employee is the lesser of two hundred fifty dollars (\$250) or the taxpayer's actual cost of providing health benefits for the taxable year. The credit is limited to insurance paid for an eligible employee whose total wages or salary from the business does not exceed forty thousand dollars (\$40,000) on an annual basis.

**b. Allocation of Credit**

Multistate corporations determine the credit by multiplying the calculated credit by the apportionment fraction used to apportion its apportionable income to this State pursuant to G.S. 105-130.4.

**c. Definitions**

The following definitions apply:

**i. Eligible employee**

Defined in G.S. 58-50-110.

**ii. Qualifying existing coverage**

Defined in G.S. 58-50-130(a)(4a).

**iii. Small business**

A taxpayer that employs no more than twenty-five (25) eligible employees throughout the taxable year.

**d. Sunset**

The credit allowed in this section sunsets for taxable years beginning on or after January 1, 2009.

**6. Credit for Biodiesel Producers (G.S. 105-129.16F)**

Effective for taxable years beginning on or after January 1, 2008, biodiesel providers that produce at least one hundred thousand (100,000) gallons of biodiesel during the taxable year are allowed a credit equal to the per gallon excise tax the producer paid under Article 36C of Chapter 105. For purposes of this credit, “biodiesel” is defined as “liquid fuel derived in whole from agricultural products, animal fats, or wastes from agricultural products or animal fats.”

The credit does not apply to tax paid on diesel fuel included in a biodiesel blend. The maximum annual credit is five hundred thousand dollars (\$500,000). The credit sunsets for taxable years beginning on or after January 1, 2010.

**7. Work Opportunity Tax Credit (G.S. 105-129.16G)**

A taxpayer who is allowed a federal work opportunity tax credit under Part IV, Subpart F of the Code is allowed to take a credit against its North Carolina corporate income or franchise tax equal to six percent (6%) of the federal credit amount.

**8. Credit for Donations to a Nonprofit Organization for Acquisition of Renewable Energy Property (G.S. 105-129.16H)**

Effective for taxable years beginning on or after January 1, 2008, a taxpayer who donates money to a tax-exempt nonprofit organization to construct, purchase, or lease renewable energy property is allowed a credit equal to the taxpayer’s proportionate share of the credit the nonprofit could have taken under G.S. 105-129.16A if the nonprofit were subject to tax. The credit must be taken in the year the property is placed in service. The installment requirement for nonresidential property in G.S. 105-129.16A does not apply. The nonprofit organization must provide each taxpayer who made a donation a statement describing the property, setting out the cost of the property, the amount of the credit the organization could claim if it were subject to tax, and the taxpayer’s share of the credit. A taxpayer claiming a credit under this section may not deduct this donation as a charitable contribution.

**D. Tax Incentives for Recycling Facilities (Article 3C)**

**1. General Information**

**a. Eligibility**

In order for a manufacturing plant to be considered a recycling facility at least seventy-five percent (75%) of its products must be made from materials that consist of at least fifty percent (50%) post-consumer waste material measured by weight or volume. The term “recycling facility” includes real and personal property located at or on land in the same county and reasonably near the plant site that are used to perform business functions related to the plant or to transport materials and products to or from the plant. A plant may qualify as either a major recycling facility or a large recycling facility.

**i. Major Recycling Facility (G.S. 105-129.26(a))**

A recycling facility qualifies for the tax credits provided under Article 3C for major recycling facilities if it meets all of the following conditions:

- The facility is located in an area that was an enterprise tier one area at the time the owner began construction of the facility.
- The Secretary of Commerce has certified that the owner will, by the end of the fourth year after the year the owner begins construction of the recycling facility, invest at least three hundred million dollars (\$300,000,000) in the facility and create at least two hundred fifty (250) new, full-time jobs at the facility.
- The jobs at the recycling facility meet the wage standard in effect as of the date the owner begins construction of the facility.

**ii. Large Recycling Facility (G.S. 105-129.26(b))**

A recycling facility qualifies for the tax credit provided in G.S. 105-129.27 for large recycling facilities if it meets all of the following conditions:

- The facility is located in an area that was an enterprise tier one area at the time the owner began construction of the facility.
- The Secretary of Commerce has certified that the owner will, by the end of the second year after the year the owner begins construction of the recycling facility, invest at least one hundred fifty million dollars (\$150,000,000) in the facility and creates at least one hundred fifty-five (155) new, full-time jobs at the facility.
- The jobs at the recycling facility meet the wage standard in effect as of the date the owner begins construction of the facility.

**b. Forms**

Form CD-425 is used to report any tax credits claimed under this article. This form must be filed for any taxable year in which a credit or a carryforward of a credit against the taxpayer's tax liability for that year is claimed.

**c. Substantiation (G.S. 105-129.26(d))**

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.

**d. Forfeiture (G.S. 105-129.26(c))**

If the owner of a large or major recycling facility fails to make the required minimum investment or create the required number of new jobs within the period certified by the Secretary of Commerce, the recycling facility forfeits all tax credits previously received under this Article. Forfeiture does not occur, however if the failure was due to events beyond the owner's control.

Upon forfeiture, the owner is liable for a tax equal to the amount of all past taxes avoided as a result of the tax credits claimed plus interest at the rate established in G. S. 105-241.21, computed from the date the taxes would have been due if the tax benefits had not been received. The tax and interest are due thirty (30) days after the date of the forfeiture. An owner that fails to pay the tax and interest is subject to the penalties provided in G.S. 105-236.

## **2. Credit for Investing in Large or Major Recycling Facility (G.S. 105-129.27)**

### **a. Credit**

An owner that purchases or leases machinery and equipment for a major recycling facility in this State during the taxable year is allowed a credit equal to fifty percent (50%) of the amount payable by the owner during the taxable year to purchase or lease the machinery and equipment.

An owner that purchases or leases machinery and equipment for a large recycling facility in this State during the taxable year is allowed a credit equal to twenty percent (20%) of the amount payable by the owner during the taxable year to purchase or lease the machinery and equipment.

### **b. Taxes Credited (G.S. 105-129.27(b))**

The credit provided in this section is allowed against franchise and income tax. Any other nonrefundable credits allowed the owner are subtracted before the credit allowed by this section. The taxpayer must elect the tax against which a credit will be claimed when filing the return on which the credit is first claimed. All carryforwards of a credit must be claimed against the same tax.

### **c. Credit Carryforward (G.S. 105-129.27(c))**

The credit may not exceed the amount of tax against which it is claimed for the taxable year, reduced by the sum of all other credits allowed against that tax, except tax payments made by or on behalf of the owner. Any unused portion of the credit may be carried forward for the succeeding twenty five (25) years.

### **d. Change in Ownership of Facility (G.S. 105-129.27(d))**

The sale, merger, consolidation, conversion, acquisition, or bankruptcy of a recycling facility, or any transaction by which the facility is reformulated as another business, does not create new eligibility in a succeeding owner with respect to a credit for which the predecessor was not eligible under this section. A successor business may, however, take any carried-over portion of a credit that its predecessor could have taken if it had a tax liability.

### **e. Forfeiture (G.S. 105-129.27(e))**

If any machinery or equipment for which a credit was allowed under this section is not placed in service within thirty (30) months after the credit was allowed, the credit is forfeited. A taxpayer that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. 105-241.21, computed from the date the taxes would have been due if the credit had not been

allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the penalties provided in G.S. 105-236.

**f. Limitations (G.S. 105-129.27(f))**

A recycling facility that is eligible for the credit allowed in this section is not allowed the credit for investing in machinery and equipment provided in G.S. 105-129.9.

**3. Credit for Reinvestment (G.S. 105-129.28)**

(Repealed effective for taxable years beginning on or after January 1, 2008)

**a. Credit (G.S. 1105-129.28(a))**

A major recycling facility that is not accessible by ocean barge or ship and that transports materials to the facility or products away from the facility is allowed a credit against corporate income tax. The credit is equal to the additional transportation and transloading expenses incurred by the facility with respect to the materials and products due to its inability to use ocean barges or ships.

The additional expenses for which credit is allowed are expenses due to using river barges and expenses due to having to use another mode of transportation because the quantity that is transported by river barge is insufficient to meet the facility's needs.

To claim the credit allowed by this section, the facility must provide the Secretary of Commerce audited documentation of the amount of its additional transportation and transloading expenses incurred during the taxable year.

**b. Cap on Credit (G.S. 105-129.28(b))**

The credit allowed to a major recycling facility may not exceed the applicable annual cap provided in the following table:

Taxable Year	Cap
1998	\$ 150,000
1999	640,000
2000	3,860,000
2001	8,050,000
2002	9,550,000
2003	10,100,000
2004-2007	10,400,000

**c. Reduction in Credit (G.S. 105-129.28(c))**

For the first ten taxable years after the owner begins transporting materials and products to and from the major recycling facility, the credit allowed must be reduced by the amount of credit allowed in previous years that was used for a purpose other than an allowable purpose under G.S.105-129.28(d), as certified by the Secretary of Commerce.

**d. Use of Credited Amount (G.S. 105-129.28(d))**

For the first ten taxable years after the owner begins construction of the major recycling facility, the owner must use the credit allowed to pay for

- Investment in rail or roads associated with the facility.
- Investment in water system infrastructure designed to reduce the expense of transporting materials and products to and from the recycling facility.
- Investment at or in connection with the recycling facility above the required investment of three hundred million dollars (\$300,000,000), if the owner determines that there are no reasonable economic opportunities for the expenditures described above.

Expenses incurred for the purposes allowed in this subsection during a taxable year in the ten-year period may be counted toward a credit allowed in a later taxable year in the ten-year period. If the owner is not able to use the entire credit during the taxable year, the excess may be used in subsequent taxable years. After the end of the ten-year period, any unused credit may be used for investment at or in connection with the recycling facility above the three hundred million dollars (\$300,000,000) initial investment.

**e. Refundable Credit (G.S. 105-129.28(e))**

If the credit allowed by this section exceeds the corporate income tax liability for the taxable year reduced by the sum of all credits allowable, a refund of the excess will be made to the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits.

**E. Historic Rehabilitation Tax Credits (Article 3D)**

**1. General Information**

**a. Tax Credited (G.S. 105-129.37(a))**

The credits provided in this Article are allowed only against income tax.

**b. Credit Limitations (G.S. 105-129.37(b))**

A credit allowed may not exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

A credit must be taken in five equal installments beginning with the taxable year in which the property is placed in service. Any unused portion of a credit may be carried forward for the succeeding five years.

**c. Forms**

Form CD-425 is used to report any tax credits claimed under this article. This form must be filed for any taxable year in which a credit or an installment of a credit against the taxpayer's tax liability for that year is claimed.

**2. Credit for Rehabilitating Income-Producing Historic Structure (G.S. 105-129.35)**

**a. Credit (G.S. 105-129.35(a) and G.S. 105-129.37(a))**

A taxpayer that is allowed a federal income tax credit under section 47 of the Code for making qualified rehabilitation expenditures for a certified historic structure located in North Carolina is allowed a State income tax credit equal to twenty percent (20%) of the expenditures that qualify for the federal credit. The tax credit is forty percent (40%) of qualifying expenditures if the certified historic structure is a facility that at one time served as a State training school for juvenile offenders.

**b. Allocation (G.S. 105-129.35(b) and (c))**

Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for the credit may allocate the credit among any of its owners at its discretion as long as an owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the certified historic structure is placed in service, is at least forty percent (40%) of the amount of credit allocated to that owner. Owners to whom a credit is allocated are allowed the credit as if they had qualified for the credit directly. A pass-through entity and its owners must include a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. 105-131.8 or G.S. 105-269.15 with their tax returns for every taxable year in which an allocated credit is claimed. A pass-through entity includes a Subchapter S corporation, a limited liability company, a limited partnership, a general partnership and a joint venture. An owner of a pass-through entity is an individual or entity who is treated as an owner under the federal tax laws.

**c. Forfeiture for Disposition (G.S. 105-129.37(c))**

A taxpayer who is required under section 50 of the Code to recapture all or part of the federal credit for rehabilitating an income-producing historic structure located in this State forfeits the corresponding part of the State credit allowed with respect to that historic structure. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allowed.

**d. Forfeiture for Change in Ownership (G.S. 105-129.37(d))**

If an owner of a pass-through entity that has qualified for the credit allowed disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the rehabilitated historic structure is placed in service and the owner's interest is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the historic structure was placed in service, the owner forfeits a portion of the credit. The amount forfeited is determined by multiplying the amount of credit by the percentage reduction in ownership and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code. The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

**e. Exceptions to Forfeiture (G.S. 105-129.37(e))**

Forfeiture for change in ownership is not required if the change in ownership is the result of any of the following:

- The death of the owner.
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

**f. Liability from Forfeiture (G.S. 105-129.37(f))**

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. 105-241.21, computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the taxes and interest by the due date is subject to penalties as provided in G.S. 105-236.

**g. Substantiation (G.S. 105-129.35(a))**

A taxpayer claiming this credit must attach to the return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has been properly rehabilitated.

**3. Credit for Rehabilitating Non-income-Producing Historic Structure (G.S. 105-129.36)**

**a. Credit (G.S. 105-129.36(a) and G.S. 105-129.36(b))**

A taxpayer that is not allowed a federal income tax credit under section 47 of the Code and who incurs rehabilitation expenses for a non-income producing State-certified historic structure is allowed a credit against North Carolina income tax.

The amount of the credit is thirty percent (30%) of the rehabilitation expenses taken in five equal installments beginning with the taxable year in which the property is placed in service. The tax credit is forty percent (40%) of qualifying expenditures if the certified historic structure is a facility that at one time served as a State training school for juvenile offenders.

Rehabilitation expenses do not include the cost of acquiring the property, site work, personal property or cost attributable to the enlargement of the existing property.

**b. Eligibility (G.S. 105-129.36(a))**

To qualify for the credit, the taxpayer's rehabilitation expenses must exceed twenty-five thousand dollars (\$25,000) within a twenty-four-month period.

**c. Substantiation (G.S. 105-129.36(a))**

To claim the credit, a taxpayer must attach to the return a copy of the certification issued by the State Historic Preservation Officer.

**F. Low-Income Housing Tax Credits (Article 3E)**

**1. Credit for Low-income Housing Awarded a Federal Credit Allocation before January 1, 2003 (G.S. 105-129.41)**

**a. Credit (G.S. 105-129.41(a))**

A taxpayer is allowed a tax credit for low-income housing for North Carolina tax purposes equal to a percentage of the total federal income tax credit allowed for the taxable year under section 42 of the Code with respect to a qualified North Carolina low-income building.

**b. Computation of Credit (G.S. 105-129.41(a))**

The amount of the credit is equal to seventy-five percent (75%) of the total federal credit if the building is located in a tier one or tier two area. For buildings in other tier designations, the credit is equal to twenty-five (25%) of the total federal credit.

The total federal credit is the total allowed during the ten-year federal credit period plus the disallowed first year credit allowed in the 11<sup>th</sup> year. The total federal credit is calculated based on the qualified basis as of the end of the first year of the credit period and is not recalculated to reflect subsequent increases in the basis.

**c. Franchise, Income, or Gross Premiums Tax Election (G.S. 105-129.41(a1))**

A taxpayer may claim a credit for low-income housing against franchise, income or insurance gross premiums tax. A taxpayer must elect the tax against which a credit will be claimed when filing the return on which the first installment of the credit is claimed. The election is binding. Any carryforwards of a credit must be claimed against the same tax.

**d. Cap on Credit and Carryforward Provisions G.S. 105-129.41(a2))**

Total credits claimed under Article 3E may not exceed fifty percent (50%) of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits, including carryforwards, against that tax, except tax payments made by or on behalf of the taxpayer.

Unused portions of the credits may be carried forward for the succeeding five years unless otherwise noted, but must be taken against the same tax as on the return on which the credit was first taken.

**e. Timing of Credit (G.S. 105-129.41(b))**

The credit is taken in five equal installments beginning in the first taxable year in which the federal credit is taken. The amount of the installment for the first year must be multiplied by the applicable fraction under section 42(f)(2)(A) of the Code. Any reduction in the amount of the first installment as a result of this multiplication is carried forward and may be taken in the first taxable year after the fifth installment is allowed.

**f. Allocation (G.S. 105-129.41(b1))**

Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for the credit provided in this section may allocate the credit among any of its owners at its discretion as long as the owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the federal credit is first claimed is at least forty percent (40%) of the amount of credit allocated to that owner. Owners to whom a credit is allocated are allowed the credit as if they had qualified for the credit directly. A pass-through entity and its owners must include, with their tax returns for every taxable year in which an allocated credit is claimed, a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. 105-131.8 or G.S. 105-269.15.

**g. Qualified Building (G.S. 105-129.41(c)(1), (2) and (3))**

For purposes of the credit, a building is a "qualified North Carolina low-income building" if it was allocated a federal income tax credit under section 42(h)(1) of the Internal Revenue Code, and meets any of the following conditions:

- It is located, at the time the federal credit is allocated to the building, in a tier one or tier two area.
- It is located, at the time the federal credit is allocated to the building, in a tier three or tier four area and forty percent (40%) of its residential units are both rent-restricted and occupied by individuals whose income is fifty percent (50%) or less of the area median gross income.
- It is located, at the time the federal credit is allocated to the building, in a tier five area and forty percent (40%) of its residential units are both rent-restricted and occupied by individuals whose income is thirty-five percent (35%) or less of area median gross income.

**h. Expiration (G.S. 105-129.41(d))**

If, in one of the five years in which an installment of the credit accrues, the taxpayer becomes ineligible for the federal credit, then the credit expires and the taxpayer may not take any remaining installments of the credit. However, the taxpayer may take the portion of an installment that accrued in a previous year and was carried forward.

**i. Forfeiture for Disposition (G.S. 105-129.41(e))**

If the taxpayer is required, under section 42(j) of the Code, to recapture all or part of the federal credit claimed, the taxpayer must report the recapture event to the Secretary and to the Housing Finance Agency and forfeits the corresponding part of the credit allowed for North Carolina purposes. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allocated. The taxpayer forfeits all or part of the State credit only if the event resulting in federal recapture occurs during the period of time during which the State credit is taken, which is either five or six years. The federal credit is taken over a period of ten or eleven years.

**j. Forfeiture for Change in Ownership (G.S. 105-129.41(f))**

If an owner of a pass-through entity that has qualified for the credit allowed under this section disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the federal credit is first claimed and the owner's interest in the pass-through entity is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the federal credit is first claimed, the owner must report the change in its percentage ownership to the Secretary and to the Housing Finance Agency and forfeits all or a portion of the State credit.

The amount forfeited is determined by multiplying the amount of the credit by the percentage reduction in ownership, and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code. The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

Forfeiture as provided in this section is not required if the change in ownership is the result of any of the following:

- The death of the owner.
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

**k. Liability from Forfeiture (G.S. 105-129.41(g))**

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. 105-241.21 computed from the date the taxes would have been due if the credit had not been allowed. The due date for past taxes and interest is thirty days after the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the past taxes and interest by the due date is subject to the penalties provided in G.S. 105-236.

**2. Credit for Low-income Housing Awarded a Federal Credit Allocation on or after January 1, 2003 (G.S. 105-129.42)**

**a. Credit (G.S. 105-129.42(b))**

A taxpayer who is allocated a federal income tax credit under section 42 of the Code to construct or substantially rehabilitate a qualified North Carolina low-income housing development is allowed a credit equal to a percentage of the development's qualified basis, as determined pursuant to section 42(d) of the Code. For the purpose of this section, qualified basis is calculated based on the information contained in the carryover allocation and is not recalculated to reflect subsequent increases or decreases. No credit is allowed for a development that uses tax-exempt bond financing.

**b. Definitions (G.S. 105-129.42(a))**

These definitions apply:

**i. Qualified Allocation Plan**

The plan governing the allocation of federal low-income housing tax credits for a particular year, as approved by the Governor after a public hearing and publication in the North Carolina Register.

**ii. Qualified North Carolina low-income housing development**

A qualified low-income project or building that is allocated a federal tax credit under section 42(h)(1) of the Code and is described in below.

**iii. Qualified Residential Unit**

A housing unit that meets the requirements of section 42 of the Code.

**c. Developments and Amounts (G.S. 105-129.42(c))**

The housing developments that are qualified North Carolina low-income housing developments and the percentage of the development's eligible basis for which a credit is allowed are:

- If forty percent (40%) of the qualified residential units are affordable to households whose income is fifty percent (50%) or less of area median income and the units are in a Low-Income county or city, the percentage of the basis for which a credit is allowed is thirty percent (30%).
- If fifty percent (50%) of the qualified residential units are affordable to households whose income is fifty percent (50%) or less of the area median income and the units are in a Moderate-Income county or city, the percentage of the basis for which a credit is allowed is twenty percent (20%).
- If fifty percent (50%) of the qualified residential units are affordable to households whose income is forty percent (40%) or less of the area median income and ten percent (10%) of the units are in a High-Income county or city, the percentage of the basis for which a credit is allowed is ten percent (10%).
- If twenty-five percent (25%) of the qualified residential units are affordable to households whose income is thirty percent (30%) or less of the area median income and ten percent (10%) of the units are in a High-Income county or city, the percentage of the basis for which a credit is allowed is ten percent (10%).

The designation of a county or city as Low Income, Moderate Income, or High Income and determinations of affordability are made by the Housing Finance Agency in accordance with the Qualified Allocation Plan in effect as of the time the federal credit is allocated. A change in the income designation of a county or city after a federal credit is allocated does not affect the percentage of the developer's eligible basis for which the credit is allowed. The affordability requirements apply for the duration of the federal tax credit compliance period.

**d. Election of Method for Receiving Tax Credit (G.S. 105-129.42(d))**

When a taxpayer to whom a federal low-income housing credit is allocated submits a request to receive a carryover allocation for that credit to the Housing Finance Agency, the taxpayer must elect to receive the tax credit in the form of either a direct tax refund or a loan generated by transferring the credit to the Housing Finance Agency. Neither a direct tax refund nor a loan received as the result of the transfer of the credit is considered taxable income.

**e. Exception When No Carryover (G.S. 105-129.42(e))**

If a taxpayer does not submit a request to receive a carryover allocation to the Housing Finance Agency, the taxpayer must elect the method for receiving the credit allowed when the taxpayer files federal Form 8609 with the Agency. The credit is claimed for the taxable year in which the federal Form 8609 is filed.

**f. Pass-Through Entity (G.S. 105-129.42(f))**

Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for the credit does not distribute the credit among any of its owners. The pass-through entity is considered the taxpayer for purposes of claiming the credit. If a return filed by a pass-through entity indicates that the entity is paying tax on behalf of the owners of the entity, the credit allowed does not affect the entity's payment of tax on behalf of its owners.

**g. Return and Payment (G.S. 105-129.42(g))**

A taxpayer may claim the credit allowed on a return filed for the taxable year in which the taxpayer receives a carryover allocation of a federal low-income housing credit. The return must state the name and location of the qualified low-income housing development for which the credit is claimed.

If a taxpayer chooses the loan method for receiving the credit, the Secretary must transfer the amount of credit allowed the taxpayer to the Housing Finance Agency. The Agency must loan the taxpayer the amount of the credit on terms consistent with the Qualified Allocation Plan. The Housing Finance Agency is not required to make a loan to a qualified North Carolina low-income housing development until the Secretary transfers the credit amount to the Agency.

If the taxpayer chooses the direct tax refund method for receiving the credit allowed, the Secretary must transfer the refundable excess of the credit allowed the taxpayer to the Housing Finance Agency. The Agency holds the refund due the taxpayer in escrow, with no interest accruing to the taxpayer during the escrow period. The Agency must release the refund to the taxpayer upon the occurrence of the earlier of the following:

- The time the Agency determines that the taxpayer has complied with the Qualified Allocation Plan and has completed at least fifty percent (50%) of

the eligible activities included in the development's eligible base.

- Within thirty (30) days after the development is placed in service date.

**h. Forfeiture (G.S. 105-129.42(c) and (h))**

The credit is forfeited if, in any tax year, the taxpayer fails to meet the affordability requirements, as determined by the Housing Finance Agency.

A taxpayer that receives a credit under this section must immediately report any recapture event under section 42 of the Code to the Housing Finance Agency. If the taxpayer or any of its owners are required, under section 42(j) of the Code, to recapture all or part of a federal credit with respect to a qualified North Carolina low-income development, the taxpayer forfeits the corresponding part of the credit allowed under this section. This requirement does not apply in the following circumstances:

- When the recapture of part or all of the federal credit is the result of an event that occurs in the sixth or subsequent calendar year after the calendar year in which the development was awarded a federal credit allocation.
- The taxpayer elected to transfer the credit allowed to the Housing Finance Agency.

**i. Liability from Forfeiture (G.S. 105-129.42(i))**

A taxpayer that forfeits all or part of the credit allowed is liable for all past taxes avoided and any refund claimed as a result of the credit plus interest at the rate established under G.S. 105-241.21. The interest rate is computed from the date the Secretary transferred the credit amount to the Housing Finance Agency. The past taxes, refund and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer that fails to pay the taxes, refund, and interest by the due date is subject to the penalties provided in G.S. 105-236.

**3. Substantiation (G.S. 105-129.43)**

A taxpayer allowed a credit under Article 3E must maintain and make available for inspection any information or record required by the Secretary or the Housing Finance Agency. The burden of proving eligibility for a credit and the amount of the credit rests upon the taxpayer.

**4. Sunset (G.S. 105-129.45)**

Article 3E is repealed effective January 1, 2010. The repeal applies to developments to which federal credits are allocated on or after January 1, 2010.

**G. Research and Development Tax Credit (Article 3F)**

**1. General Information**

**a. Administration (G.S. 105-129.51)**

Any taxpayer, regardless of its type of business, is allowed a tax credit for qualified North Carolina research expenses, if the taxpayer meets the eligibility requirements

relating to wage standard, health insurance, environmental impact, and safety and health programs found in G.S. 105-129.83(c), (d), (e) and (f).

**b. Tax election (G.S. 105-129.52)**

A taxpayer may claim the credit allowed in Article 3F against either franchise or income tax. The taxpayer must elect the tax against which the credit will be claimed when filing the return on which the credit is first claimed. The election is binding and applies to both the credit and any carryforwards of the credit.

**c. Cap (G.S. 105-129.52)**

The credit allowed in Article 3F cannot exceed fifty percent (50%) of the amount of tax against which it is claimed, reduced by the sum of all other tax credits allowed against that tax. This limitation applies to the cumulative amount of credit, including carryforwards. Any unused portion of this credit may be carried forward for the succeeding fifteen (15) taxable years.

**d. Substantiation (G.S. 105-129.53)**

Each taxpayer that claims a credit under Article 3F must maintain and make available for inspection any information or records required by the Secretary. The burden of proof for a credit and the amount of the credit rests upon the taxpayer.

**e. Forms**

The Form NC-478 series is used to calculate and report tax credits, including the Article 3F credits, that are limited to fifty percent (50%) of the taxpayer's tax less the sum of all other credits that the taxpayer claims. Form NC-478I is used to calculate the research and development tax credits without regard to the fifty percent (50%) limitation. Form NC-478 is used to total the specific credits, to determine if the fifty percent (50%) applies, and, if so, to allocate the limited total credit among the specific credits.

**f. Sunset (G.S. 105-129.51)**

Article 3F is repealed for taxable years beginning on or after January 1, 2009.

**2. Definitions (G.S. 105-129.50)**

The definitions in section 41 of the Code apply in this Article. Additionally, the following definitions apply also:

**a. North Carolina university research expenses**

Any amount the taxpayer paid or incurred to a research university for qualified research performed in this State or basic research performed in this State.

**b. Period of measurement**

Defined in the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13CFR121.104), the period of measurement is used to determine the entity's annual receipts and is determined by how long an entity has been in business.

If the entity has been in business for less than three years, the annual receipts for the period of measurement are the receipts for the period of time for which the entity has been in business divided by the number of weeks in business and multiplied by fifty-two (52).

If the entity has been in business for three full fiscal years and has not filed a short-period income tax return for any of those three years, the annual receipts for the period of measurement are the total receipts over the last three years divided by three.

If one of the three years' returns is a short-period return, the annual receipts for the period of measurement are the receipts for the short year and the two full years divided by the total number of weeks in the short year and two full years divided by fifty-two (52).

**c. Qualified North Carolina research expenses**

Qualified research expenses, other than North Carolina university research expenses, for research performed in this State.

**d. Receipts**

Defined in the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13CFR121.104), receipts means total income, gross income plus cost of goods sold as reported for federal income tax purposes, less net capital gains or losses and taxes collected for and remitted to a taxing authority to the extent included in gross or total income, proceeds from transactions between the entity and its domestic or foreign affiliates if also excluded from gross or total income on a federal consolidated return, and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

**e. Related person**

Defined in G.S. 105-163.010 and IRC sections 267(b) or 707(b).

**f. Research university**

An institution of higher education that:

- Is classified in the most recent edition of 'A Classification of Institutions of Higher Education', the official report of The Carnegie Foundation for the Advancement of Teaching as one of the following:
  - Doctoral/Research Universities, Extensive or Intensive.
  - Masters Colleges and Universities, I or II.
  - Baccalaureate Colleges, Liberal Arts or General.
- Is a constituent institution of The University of North Carolina.

**g. Small business**

A business whose annual receipts, combined with the annual receipts of all related persons, for the applicable period of measurement did not exceed one million dollars (\$1,000,000).

**3. Credit for North Carolina Research and Development (G.S. 105-129.55)**

The credit allowed in this article consists of two parts:

**a. Credit for qualified North Carolina research expenses**

The credit is equal to a percentage of the expenses based on whether the expenses qualify as small business, low tier research, or other research. Only one credit is allowed with respect to the same expenses. If the expenses qualify in more than one category, then the credit is equal to the higher percentage, not both percentages combined. If part of the taxpayer's expenses qualify as low-tier and part of the expenses qualify as other research, the applicable percentages apply separately to each part of the expenses.

If the taxpayer was a small business as of the last day of the taxable year, the applicable percentage is three and twenty-five hundredths percent (3.25%). Research performed in a development tier one area is considered low-tier research and the applicable percentage is three and twenty-five hundredths percent (3.25%). Research expenses that do not qualify as small business or low-tier are considered other research.

If other research expenses are greater than zero but not greater than fifty million dollars (\$50,000,000), the applicable percentage is one and twenty-five hundredths percent (1.25%). If other research expenses are greater than fifty million dollars (\$50,000,000), but not greater than two hundred million dollars (\$200,000,000), the applicable percentage is two and twenty-five hundredths percent (2.25%). If other research expenses are greater than two hundred million dollars (\$200,000,000), the applicable percentage is three and twenty-five hundredths percent (3.25%).

**b. Credit for North Carolina university research expenses**

A taxpayer that has expenses for research performed by an institution within the North Carolina university system is allowed a credit equal to twenty percent (20%) of the expenses.

**H. Tax Incentives for Major Computer Manufacturing Facilities (Article 3G)**

**1. General Information**

A computer manufacturer that meets all the eligibility requirements is eligible for a tax credit for making a substantial investment and significantly increasing employment levels in North Carolina.

**a. Tax election (G.S. 105-129.64, G.S. 105-129.65)**

The credit allowed by this Article may be taken against franchise taxes and income taxes.

**b. Allocation (G.S. 105-129.65)**

When claiming a credit under this Article, taxpayers must elect the percentage of the credit to be applied against their franchise taxes with any remaining percentage to be applied against their income taxes. This election is not binding for the year in which it is made or for any carryforwards of that year's credit. Taxpayers may elect a different allocation for each year in which they qualify for a credit.

**c. Cap (G.S. 105-129.65)**

The amount of credit claimed in a taxable year under this Article is limited to the lesser of the amount determined under G.S. 105 129.64 and the total amount of franchise and income tax due for the year, reduced by the sum of all other credits allowed against those taxes, except tax payments made by or on behalf of the taxpayer. Credits that are limited to fifty percent (50%) of the taxpayer's liability must be taken before credits that may eliminate all of a taxpayer's liability, which in turn must be taken before any credits that are refundable. This limitation applies to the cumulative amount of the credit allowed in any tax year, including carryforwards claimed by the taxpayer under this Article for previous tax years.

**d. Make Up Account (G.S. 105-129.65)**

If the amount of the credit calculated based on output exceeds the applicable cap in any year, the excess credit may be credited to a make up account. Amounts credited to the make up account remain in the account for a period of time equal to the earlier of seven years or until they are used.

If the amount of the credit calculated based on output is less than the applicable cap in any year, the taxpayer is allowed to use excess credit amounts available in the make up account to increase the credit allowed for that taxable year to the cap amount, as adjusted by any applicable employment level adjustment factor. A successor in business may take the amounts available in a make up account of a predecessor corporation as if they were excess credits available in a make up account of the successor in business.

**e. Carryforward (G.S. 105-129.65)**

Any unused portion of a credit allowed may be carried forward for the next succeeding twenty-five (25) years. A successor in business may take the carryforwards of a predecessor corporation as if they were carryforwards of a credit allowed to the successor in business.

**f. Substantiation (G.S. 105-129.63)**

The taxpayer is responsible for providing all information needed to verify eligibility for the credit, including the determination by the Secretary of Commerce, the certification relating to the related entities or strategic partners of the taxpayer and any additional information requested by the Department of Revenue.

The taxpayer must apply to the Secretary of Commerce for the determination required under G.S. 105 129.62 (see 3.a.). The application must be made under oath

and must provide any information the Secretary requires to make the determination. The determination by the Secretary of Commerce is a factual determination. The Secretary must make this determination in any case in which the taxpayer can demonstrate performance or can provide a credible plan for performance.

The taxpayer must provide, with the tax return for each year that a credit or carryforward of a credit is claimed, a certification that the taxpayer and the taxpayer's related entities and strategic partners whose employees are included in the taxpayer's increased employment level continue to provide health insurance for all the full-time jobs at the facility with respect to which the credit is claimed.

**g. Forfeiture (G.S. 105-129.63)**

The taxpayer forfeits any credits claimed under this Article with respect to the facility if the taxpayer fails to continuously meet all eligibility requirements, create the required number of new jobs or to make the required investment, or if the information provided by the taxpayer on the application proves to have been false at the time it was given, and the person making the application knew or should have known that the information was false. A taxpayer that forfeits a credit under this Article is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. 105 241.21, computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the penalties provided in G.S. 105 236.

**h. Sunset (G.S. 105-129.66)**

This Article is repealed for business activities occurring in taxable years beginning on or after January 1, 2020.

**2. Definitions (G.S. 105-129.61)**

**a. Computer Manufacturing (G.S. 105-164.14)**

Computer manufacturing means manufacturing or assembling electronic computers, such as personal computers, workstations, laptops, and computer servers. The term includes the assembly or integration of processors, coprocessors, memory, storage, and input/output devices into a user-programmable final product. The term includes manufacturing or assembling computer peripheral equipment, such as storage devices, printers, monitors, input/output devices, and terminals only if the manufacture or assembly of this peripheral equipment occurs at a facility or campus at which the taxpayer also manufactures or assembles electronic computers.

**b. Facility**

A single building or structure or a group of buildings or structures that are located on a single parcel of land or on contiguous parcels of land under common ownership and any other related real property contained on the parcel or parcels.

**c. Full-time Job / Full-time Equivalent**

A permanent position that requires at least sixteen hundred (1,600) hours of work per year and is intended to be held by one employee during the entire year.

A full-time equivalent results when the total hours per year for two or more new permanent part-time jobs equal sixteen hundred (1600) hours.

**d. Increased Employment Level**

The total number of new full time jobs and new permanent part time jobs converted into full time equivalences created by the taxpayer at the facility with respect to which the credit is claimed, either directly or indirectly through a related entity or strategic partner, as of December 31 as compared to the employment level of the taxpayer as of December 31 in the year in which the taxpayer begins construction of the facility with respect to which the credit is claimed or as of the date the Secretary of Commerce makes the written determination required under G.S. 105 129.62, whichever is earlier. Jobs transferred from one area in the State to another area in the State are not considered new jobs for the purposes of this Article and may not be included in the increased employment level.

**e. Related Entity**

An entity for which the taxpayer possesses directly or indirectly at least eighty percent (80%) of the control and value.

**f. Strategic Partner**

A business that is engaged in activities at the facility that directly contribute to the manufacture and distribution of computers and computer peripherals and with whom the taxpayer has contracted to provide those activities at the facility in direct support of its manufacturing and distribution activities.

**g. Successor in Business**

A corporation that through amalgamation, merger, acquisition, consolidation, or other legal succession becomes invested with the rights and assumes the burdens of the predecessor corporation and continues the computer manufacturing and distribution business.

**h. Unit Output**

The total number of computers and computer peripherals produced, assembled, or manufactured at the facility during the taxable year.

**3. Eligibility (G.S. 105-129.62)**

To be eligible for the credit allowed under this Article, a taxpayer must meet all of the following eligibility requirements.

**a. Determination by Secretary of Commerce**

With respect to a facility in this State, the Secretary of Commerce must make a written determination that

- The taxpayer has or is expected to have an increased employment level at the facility of at least twelve hundred (1,200) within five years after the time that the facility is first used as a computer manufacturing and distribution facility, and
- The taxpayer, either directly or indirectly through a related entity or strategic partner, has invested or is expected to invest at least one hundred million dollars (\$100,000,000) in private funds to construct a computer manufacturing and distribution facility over a five year period.

For the purposes of this Article, costs of construction may include costs of acquiring and improving land for the facility, costs for renovations or repairs to existing buildings, and costs of equipping or reequipping the facility.

**b. Health Insurance**

A taxpayer and the taxpayer’s related entities and strategic partners whose employees are included in the taxpayer’s increased employment level must provide health insurance for all of the full-time jobs at the facility with respect to which the credit is claimed each year it claims a credit or carryforward of a credit.

For the purposes of this subsection, an entity provides health insurance if it pays at least fifty percent (50%) of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125.

If the taxpayer, or a related entity or strategic partner of the taxpayer whose employees are included in the increased employment level of the taxpayer, ceases to provide health insurance for the jobs during a taxable year, the credit expires and the taxpayer may not take any remaining carryforward of the credit.

**c. Environmental Impact**

As of the last day of the taxable year for which a credit or carryforward is claimed, the taxpayer and the taxpayer’s related entities and strategic partners whose employees are included in the taxpayer’s increased employment level must meet both of these conditions:

- Have no pending administrative, civil, or criminal enforcement actions based on alleged significant violations of any program implemented by an agency of the Department of Environment and Natural Resources, and
- Have had no final determination of responsibility for any significant administrative, civil, or criminal violation of any program implemented by an agency of the Department of Environment and Natural Resources within the last five years.

A significant violation is a violation or alleged violation that does not satisfy any of the conditions of G.S. 143 215.6B(d).

For the taxpayer's related entities and strategic partners, this subsection applies only to the activities of the related entity or strategic partner at the facility with respect to which a credit is claimed.

Upon request, the Secretary of Environment and Natural Resources must notify the Department of Revenue of whether a person currently has any of these pending actions or has had any of these final determinations within the last five years.

**d. Safety and Health Programs**

As of the last day of the taxable year for which a credit or carryforward is claimed, the taxpayer and the taxpayer's related entities and strategic partners whose employees are included in the taxpayer's increased employment level must have no citations under the Occupational Safety and Health Act at the facility with respect to which the credit is claimed that have become a final order within the past three years for willful serious violations or for failing to abate serious violations. For the purposes of this subsection, "serious violation" has the same meaning as in G.S. 95-127.

Upon request, the Secretary of Labor must notify the Department of Revenue of whether a person has had these citations become final orders within the past three years.

**e. Overdue Tax Debts**

The taxpayer and the taxpayer's related entities and strategic partners whose employees are included in the taxpayer's increased employment level must have no overdue tax debts that have not been satisfied or otherwise resolved as of the last day of the taxable year for which a credit or carryforward is claimed.

**f. Relationship with Related Entities and Strategic Partners**

A taxpayer must obtain the written consent of related entities and strategic partners to include jobs created by those entities in the taxpayer's increased employment level.

If a taxpayer fails to obtain this written consent, the taxpayer may not include jobs created by the applicable business in its increased employment level. This consent, once granted, is irrevocable.

A job may not be included in the increased employment level of more than one entity.

**4. Credit for Major Computer Manufacturing Facility (G.S. 105-129.64)**

A taxpayer that meets all the eligibility requirements of G.S. 105-129.62 is eligible for a credit against franchise and income taxes. For taxable years beginning with the 2006 taxable year, the amount of the credit allowable in a year is determined based on the taxable year, the unit output of the facility, the production factor, and the increased employment level at the facility in the current taxable year and previous taxable years.

**a. 2005 Taxable Year**

For taxable years beginning on or after January 1, 2005, but before January 1, 2006, the amount of the credit is equal to ten million dollars (\$10,000,000) if the taxpayer, either directly or through a related entity, has invested at least twenty five million dollars (\$25,000,000) in private funds by the end of the taxable year to construct a computer manufacturing and distribution facility in this State.

**b. 2006-2009 Taxable Years**

For taxable years beginning on or after January 1, 2006, but before January 1, 2010, the maximum amount of the credit is ten million dollars (\$10,000,000).

The amount of the credit that may be claimed is determined by multiplying the employment level adjustment factor by the lesser of ten million dollars (\$10,000,000) and the product of the unit output of the facility and the applicable production factor listed in (e) below.

For the purposes of this subsection, the employment level adjustment factor is the lesser of one and the number derived by dividing the taxpayer's increased employment level for the year by the applicable target increased employment level provided in the table below:

Year	Target Increased Employment Level
2006	600
2007	1,000
2008	1,100
2009	1,500

**c. 2010-2014 Taxable Years**

For taxable years beginning on or after January 1, 2010, but before January 1, 2015, the maximum amount of the credit is fifteen million dollars (\$15,000,000) if the taxpayer has in any year attained an increased employment level of one thousand five hundred (1,500). Otherwise the maximum amount of the credit is ten million dollars (\$10,000,000). The amount of the credit is determined as follows:

- If the taxpayer has ever attained an increased employment level of at least one thousand five hundred (1,500), the amount of the credit that may be claimed is the lesser of fifteen million dollars (\$15,000,000) and the amount determined by multiplying the unit output of the facility by the applicable production factor listed in (e) below. If the taxpayer's increased employment level has decreased by more than forty percent (40%) from that of the previous taxable year, the amount of the credit that may be claimed must be reduced by multiplying the amount determined under this subdivision by a fraction, the numerator of which is the taxpayer's increased employment level for the taxable year and the denominator of which is one thousand five hundred (1,500).
- If the taxpayer has never attained an increased employment level of at least

one thousand five hundred (1,500), the amount of the credit that may be claimed is equal to the employment level adjustment factor multiplied by the lesser of ten million dollars (\$10,000,000) and the product of the unit output of the facility and the applicable production factor listed in (e) below. For the purposes of this subdivision, the employment level adjustment factor is the lesser of one and the number derived by dividing the taxpayer's increased employment level for the year by one thousand five hundred (1,500).

**d. 2015-2019 Taxable Years**

For taxable years beginning on or after January 1, 2015, but before January 1, 2020, the maximum amount of the credit is twenty million dollars (\$20,000,000) if the taxpayer has in any year attained an increased employment level of two thousand five hundred (2,500). If the taxpayer has in any year attained an increased employment level of at least one thousand five hundred (1,500), but in no year has attained an increased employment level of at least two thousand five hundred (2,500), the maximum amount of the credit is fifteen million dollars (\$15,000,000). Otherwise the maximum amount of the credit is ten million dollars (\$10,000,000).

The amount of the credit is determined as follows:

- If the taxpayer has ever attained an increased employment level of at least two thousand five hundred (2,500) and the taxpayer's increased employment level for the current year is at least one thousand five hundred (1,500), the amount of the credit is the lesser of twenty million dollars (\$20,000,000) and the amount determined by multiplying the unit output of the facility by the applicable production factor listed in (e) below.
- If the taxpayer has ever attained an increased employment level of at least one thousand five hundred (1,500) but has never attained an increased employment level of at least two thousand five hundred (2,500), or if the taxpayer has ever attained an increased employment level of at least two thousand five hundred (2,500) and the taxpayer's current increased employment level is less than one thousand five hundred (1,500), the amount of the credit that may be claimed is the lesser of fifteen million dollars (\$15,000,000) and the amount determined by multiplying the unit output of the facility by the applicable production factor listed in (e) below.

If the taxpayer's increased employment level has decreased by more than forty percent (40%) from that of the previous taxable year and (1) the increased employment level of the previous year was one thousand five hundred (1,500) or less or (2) the increased employment level of the current year is nine hundred (900) or less, the amount of the credit that may be claimed must be reduced by multiplying the amount determined under this subdivision by a fraction, the numerator of which is the taxpayer's increased employment level for the taxable year and the denominator of which is one thousand five hundred (1,500).

- If the taxpayer has never attained an increased employment level of at least one thousand five hundred (1,500), the amount of the credit that may be claimed is equal to the employment level adjustment factor multiplied by the lesser of ten million dollars (\$10,000,000) and the product of the unit output of the facility and the applicable production factor listed in (e) below. For the purposes of this subdivision, the employment level adjustment factor is the lesser of one and the number derived by dividing the taxpayer's employment level for the year by one thousand five hundred (1,500).

**e. Production Factor**

For taxable years beginning on or after January 1, 2006, but before January 1, 2007, the production factor is fifteen dollars (\$15.00). For all other taxable years, the production factor is six dollars and twenty five cents (\$6.25).

**f. Expiration**

If the taxpayer fails to attain an increased employment level of at least one thousand two hundred (1,200), either directly or in conjunction with its strategic partners and related entities, within five years after beginning construction of the facility with respect to which a credit is claimed or the taxpayer fails to invest at least one hundred million dollars (\$100,000,000) in private funds to construct a computer manufacturing and distribution facility over a five-year period, the taxpayer may not take any further credits under this Article with respect to that facility. Failure to attain an increased employment level of one thousand two hundred (1,200) within the five years or to invest at least one hundred million dollars (\$100,000,000) in private funds to construct the facility does not result in forfeiture of credits previously taken under this section unless the provisions of G.S. 105-129.63 apply.

**I. Credit for Mill Rehabilitation (Article 3H)**

**1. General Information (G.S. 105-129.73 (a))**

A taxpayer that places eligible rehabilitated mill property into service is allowed a credit against either franchise tax, corporate income tax or gross premiums tax. The taxpayer must elect the tax against which the credit is being claimed when filing the return on which the credit is claimed. The election is binding and any installments or carryforwards of the credit must be claimed against the same tax.

**a. Cap on credit (G.S. 105-129.73(b))**

The credit cannot exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by or on behalf of the taxpayer. Any unused credit may be carried forward for the succeeding nine years.

**b. Coordination with Article 3D (G.S.105-129.74)**

A taxpayer claiming a credit under this Article cannot also claim a credit under Article 3D with respect to the same activity. The authority given to the North Carolina Historical Commission in Article 3D to establish rules and fees also applies to this Article.

**c. Sunset (G.S. 105-129.75)**

The credit expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2011.

**2. Credit for income-producing rehabilitated mill property (G.S. 105-129.71)**

**a. Credit**

A taxpayer that is allowed a federal income tax credit under Code section 47 for making qualified rehabilitation expenditures with respect to an eligible site is allowed a State credit equal to a percentage of the expenditures that qualify for the federal credit. The credit may be claimed in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenditures associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is:

- Forty percent (40%) of the qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of certification.
- Thirty percent (30%) of the qualified expenditures if the eligible site is located in a tier four or five area.

**b. Allocation**

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least forty percent (40%) of the amount of credit allocated to that owner. This differs from the allocation principles in G.S. 105-131.8 and G.S. 105-269.15 that apply to all other tax credits.

Under the general allocations provisions in G.S. 105-131.8 and G.S. 105-269.15, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership must have a substantial economic effect, which means that the allocation agreement must reflect the economic interests of the partners in the partnership and cannot be based solely on tax consequences.

A statement of the allocation made under the special provision for this credit and the allocation that would have been required if this provision were not law must be included with the tax returns filed by the pass-through entity and the owners for each year in which the allocated credit is claimed.

**c. Forfeiture for change in ownership**

The owner of a pass-through entity must forfeit a portion of the credit for rehabilitating income-producing mill property if the owner disposes of more than

one-third of the owner's interest in the pass-through entity within five years from the date the eligible site is placed in service. The forfeiture amount is determined by multiplying the amount of the credit by the percentage reduction in ownership and then multiplying that product by the federal recapture percentage found in Code section 50(a)(1)(B).

**d. Exceptions to forfeiture**

Forfeiture is not required if the change in ownership is the result of:

- The death of the owner, or
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

**e. Liability from forfeiture**

An owner of a pass-through entity that forfeits a credit for change in ownership is liable for all past taxes avoided as the result of claiming the credit, plus interest at the rate established under G.S. 105-241.21 computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty days after the date the credit is forfeited. If the taxes and interest are not paid by the due date, the taxpayer is subject to the penalties in G.S. 105-236.

**3. Credit for nonincome-producing rehabilitated mill property (G.S. 105-129.72)**

**a. Credit**

A taxpayer that is not allowed a federal income tax credit under Code section 47 and that makes qualified rehabilitation expenses with respect to an eligible site is allowed a State tax credit equal to a percentage of the rehabilitation expenses. The credit may be claimed in five equal installments beginning in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenses associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is forty percent (40%) of qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of certification. No credit is allowed if the eligible site is in a tier four or five area.

**b. Allocation**

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least forty percent (40%) of the amount of credit allocated to that

owner. This differs from the allocation principles in G.S. 105-131.8 and G.S. 105-269.15 that apply to all other tax credits. Under the general allocation provisions, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership must have a substantial economic effect, which means that the allocation agreement must reflect the economic interests of the partners in the partnership and cannot be based solely on tax consequences. A statement of the allocation made under the special provision for this credit and the allocation that would have been required if this provision were not law must be included with the tax returns filed by the pass-through entity and the owners for each year in which the allocated credit is claimed.

**c. Forfeiture for change in ownership**

If an owner of a pass-through entity disposes of more than one-third of the owner's interest in the pass-through entity within five years from the date the eligible site is placed in service, the owner must forfeit a portion of the credit for rehabilitating nonincome-producing mill property. The forfeiture amount is determined by multiplying the amount of the credit by the percentage reduction in ownership and then multiplying that product by the federal recapture percentage found in Code section 50(a)(1)(B). The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

**d. Exceptions to forfeiture**

Forfeiture is not required if the change in ownership is the result of:

- The death of the owner, or
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

**e. Liability from forfeiture**

An owner of a pass-through entity that forfeits a credit for change in ownership is liable for all past taxes avoided as the result of claiming the credit, plus interest at the rate established under G.S. 105-241.21 computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. If the taxes and interest are not paid by the due date, the taxpayer is subject to the penalties provided in G.S. 105-236.

**J. Tax Credits for Growing Businesses (Article 3J)**

Guidelines for these credits are available by clicking on the following: <http://www.dor.state.nc.us/taxes/corporate/article3j.pdf>. These guidelines will be updated periodically as issues arise that require clarification.

## **K. Tax Incentive for Railroad Intermodal Facility (Article 3K)**

### **1. Credit (G.S. 105-129.96)**

A taxpayer that constructs or leases an eligible railroad intermodal facility in this State and places it in service during the tax year is allowed a tax credit equal to fifty percent (50%) of amounts paid by the taxpayer towards the cost of construction or under the lease. The credit may not exceed fifty percent (50%) of the tax against which it is claimed. Any unused portion of a credit may be carried forward for ten years.

### **2. Taxes Credited (G.S. 105-129.96)**

The credit is allowed against either income or franchise tax. The taxpayer must elect the tax against which the credit is claimed when filing the return on which the credit is first claimed. This election is binding. Any carryforwards of the credit must be taken against the same tax.

### **3. Definitions (G.S. 105-129.95)**

#### **a. Costs of Construction**

The costs of acquiring and improving land, constructing buildings and other structures, equipping the facility, and constructing and equipping rail tracks to the railroad intermodal facility that are necessary to access and support facility operations. In the case of property owned or leased by the taxpayer, cost is determined pursuant to regulations adopted under section 1012 of the Code.

#### **b. Eligible railroad intermodal facility**

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

#### **c. Intermodal facility**

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

#### **d. Railroad intermodal facility**

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

### **4. Substantiation (G.S. 105-129.97)**

Any taxpayer claiming this credit must maintain adequate records to determine and verify the amount of the credit and must make these records available for inspection by the Secretary. The burden of proving eligibility and the amount of the credit rests upon the taxpayer. No credit will be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

### **5. Reports (G.S. 105-129.98)**

The Department must publish a report showing the number of taxpayers claiming this credit, the amount of the credit claimed and the tax against which the credit is claimed, and the total cost to the General Fund no later than May 1 of each year.

### **6. Sunset (G.S. 105-129.99)**

This credit sunsets for taxable years beginning on or after January 1, 2038.

## **IV. DECLARATION OF ESTIMATED INCOME TAX BY CORPORATIONS (Article 4C)**

### **A. Declaration of Estimated Income Tax Required**

A declaration of estimated tax must be filed by a corporation for each taxable year in which it can reasonably be expected to have an income tax liability to North Carolina of at least five hundred dollars (\$500).

The term “estimated tax” means the amount of income tax the corporation expects to owe for the taxable year after subtracting any tax credits.

The term “taxable year,” for the purpose of filing declarations of estimated tax, means the calendar or fiscal year in which the company expects to earn the income upon which the estimated tax is based.

### **B. Payment and Due Dates**

#### **1. Form of Payment**

Form CD-429, Corporate Estimated Income Tax, is used to pay corporate estimated income tax. The taxpayer may also pay corporate estimated income tax on-line using the Department’s website, [www.dornnc.com](http://www.dornnc.com).

A corporation that is required to pay its federal estimated income tax by electronic funds transfer must pay its State estimated income tax by electronic funds transfer. For information on payments by electronic funds transfer see subsection G, Electronic Funds Transfer (EFT) Requirement, below and the “General Administration” section.

#### **2. When Due**

Declaration returns and payments of tax are due to be filed on or before the 15<sup>th</sup> day of the 4<sup>th</sup>, 6<sup>th</sup>, 9<sup>th</sup> and 12<sup>th</sup> months of the taxable year.

### **C. Underpayment of Estimated Tax**

Failure to pay the required amount of estimated income tax will subject the corporation to interest on the underpayment. Use Form CD-429B to calculate the interest.

### **D. “No Interest” Tests**

No interest for underpayment will be assessed if the estimated tax paid on or before the estimated tax due date is at least as large as the payment that would be due if the estimated tax fell into one of the following categories: (Note: Large corporations as defined in IRS Code Section 6655 are excluded from exception 1 or 2 below.)

1. It amounts to as much as the tax paid on the return of the preceding taxable year of twelve (12) months.

2. It amounts to as much as the tax would be by applying the current year's income tax rate to the corporation's taxable income in the previous year.
3. It amounts to ninety percent (90%) of the tax shown on the current annual income tax return.
4. It amounts to ninety percent (90%) of the tax that would be due on the basis of current income up to a specified cut-off date, annualized for the year.

**E. Short Taxable Years**

No estimated tax is required if the short period 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.

**F. Overpayment of Tax**

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

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

**G. Electronic Funds Transfer (EFT) Requirement (G.S. 105-163.40(d), G.S. 105-241(b))**

A corporation subject to State estimated tax is required to make the payments of its estimated tax liability by electronic funds transfer (EFT) if either of the following conditions exist:

1. The corporation is required under the Internal Revenue Code to pay its federal estimated corporate income tax by electronic funds transfer.
2. The corporation has paid estimated corporate income tax installments of two hundred forty thousand dollars (\$240,000) or more in a twelve-month period. This twenty thousand dollars (\$20,000) monthly average threshold applies separately to the corporate tax liability and is not a combination of tax liabilities from other taxing schedules.

**V. EXCISE TAX**  
**(Articles 2A, 2C, and 5E)**

**A. Tobacco Products Excise Tax (G.S. 105-113.2 – G.S. 105-113.40)**

**1. Scope (G.S. 105-113.3)**

The taxes on cigarettes and other tobacco products are collected only once on the same tobacco product. A city or county may not levy a privilege license tax on the sale of tobacco products except as permitted by this Article.

**2. Cigarette Distributor Licenses (G.S. 105-113.4A, G.S. 105-113.11, G.S. 105-113.12, 17 NCAC 04C.0201, 17 NCAC 04C.0205)**

To obtain a license required by this Article, an applicant must apply to the Secretary using Form B-A-1, Application for Cigarette Distributor's License, and pay the tax due for the license. The application must be signed and verified by oath or affirmation by:

- The owner, if a natural person
- A member or partner, if an association or a partnership, or
- If a corporation, then an executive officer, or any other person authorized in writing by the corporation.

The distributor must notify the Secretary in writing of any changes in the information previously provided on the license application as such changes occur. Additionally, each cigarette distributor must notify the cigarette manufacturers from whom non-tax-paid cigarettes are purchased or received of the cigarette distributor's license issued by the Secretary and of any subsequent changes to the license.

A license is required for each place of business. "Place of business" means any place where a distributor receives or stores non-tax-paid cigarettes. The distributor must notify the Secretary in writing of the exact location and telephone number of all warehouse or storage facilities where non-tax-paid cigarettes are received or stored before such facilities are placed in use. A license is not transferable or assignable and must be displayed at the place of business for which it is issued. The tax due for the license cannot be prorated.

A refund of a license tax is allowed only when the tax was collected and paid in error. No refund is allowed when a license holder surrenders a license or the Secretary revokes a license.

A license holder may obtain a duplicate license, without charge, if it is established that the original license has been lost, destroyed, or defaced. An amended license may be obtained, without charge, if it is established that the location of the place of business for which the license was issued has changed. Each duplicate or amended license will state that it is a duplicate or amended license, as appropriate.

### **3. Revocation of Licenses (G.S. 105-113.4B)**

The Secretary may revoke the license of any license holder who violates this Article or any Administrative Rule made pursuant to the provisions of this Article, or who engages in the illegal sale of cigarettes (G.S. 14-401.18). A license issued under this Article may be canceled upon written request of the license holder or if the Secretary finds that the license holder is incurring liability for the tax imposed under this Article after failing to pay a tax when due under this Article.

The license holder is allowed a hearing before the license is revoked. The Secretary must give a person whose license may be cancelled after a hearing at least ten (10) days written notice of the date, time and place of the hearing. The notice of a summary license cancellation and a notice of hearing must be sent by registered mail to the last known address of the license holder.

It is illegal for any distributor whose license has been suspended or revoked to sell cigarettes or permit the same to be sold during the period of such suspension or revocation on any premises occupied by said distributor, or upon other premises controlled by said distributor or others in any other manner or form whatever.

No disciplinary, penal, or regulatory proceeding or action will be barred or abated by the expiration, transfer, surrender, continuance, renewal, or extension of any license issued under the provisions of this Article.

If any person licensed under the provisions of G.S. 105-164.4, G.S. 105-164.5, G.S. 105-164.6, and G.S. 105-164.29 is convicted by any court of competent jurisdiction in the State of any offense under this Article, the Secretary is authorized to revoke any or all licenses issued to such person under the provisions of the aforesaid sections of Chapter 5 of the General Statutes.

### **4. Master Settlement Agreement (G.S. 105-113.4C)**

The Master Settlement Agreement between the states and the tobacco product manufacturers, incorporated by reference into the consent decree referred to in S.L. 1999-2, requires each state to diligently enforce Article 37 of Chapter 66 of the General Statutes. The Secretary must require the taxpayers of the tobacco excise tax to identify the amount of tobacco products of nonparticipating manufacturers sold by the taxpayers, and may impose this requirement as provided in G.S. 66-290(10). The Secretary must determine the amount of State tobacco excise taxes attributable to the products of nonparticipating manufacturers, based on the information provided by the taxpayers, and must report this information to the Office of the Attorney General.

### **5. Fire Safe Cigarettes**

Effective January 1, 2010, cigarette manufacturers must test cigarettes and file certification with the Department of Insurance that the cigarettes meet the safety standards set forth in Chapter 58, Article 92 of the North Carolina Statutes. Each package must be marked to indicate compliance with the safety act. The marking

requirement does not apply to inventory on hand as of the effective date. However, the retailer or wholesaler must have documentation to confirm that the cigarettes were purchased prior to the effective date and that the quantity purchased was comparable to the cigarettes purchased during the same period of the prior year. Distributors, agents, and retail dealers will be subject to inspection of the products by the Commissioner of Insurance, the Secretary of Revenue, or the Attorney General and their employees. Cigarettes in violation of this law may be seized by any law enforcement personnel or duly authorized representative of the Commissioner of Insurance. Seized contraband is to be turned over to the Department of Revenue for destruction after the manufacturer is given the opportunity to inspect the cigarettes.

**6. Tax on Cigarettes (G.S. 105-113.5)**

An excise tax is levied on the sale or possession for sale in this State, by a distributor, of all cigarettes at the rate of one and three-fourths cents per individual cigarette (thirty-five cents (35¢) per pack of twenty). Distributors are responsible for the tax on all packages of cigarettes received by them and should consider the desirability of insuring their cigarette inventories against loss by theft or otherwise, since distributors are liable for the tax upon any non-tax-paid cigarettes which are stolen or otherwise unaccounted for.

It is the responsibility of each wholesale cigarette dealer and retail dealer who purchases cigarettes from a distributor to determine that the tax is indicated as paid by the wording "North Carolina Cigarette Excise Tax Paid" on each invoice for cigarettes. If non-tax-paid cigarettes are received, such wholesale cigarette dealer or retail dealer must immediately notify the distributor from whom said cigarettes are purchased, with a copy to the Department. Upon such notification, the distributor from whom said cigarettes were purchased must immediately determine if the tax has been paid and make the necessary invoice changes to their customer as well as make any payment corrections to the Department with applicable penalty and interest.

**7. Use Tax Levied (G.S. 105-113.6)**

A tax is levied upon the sale or possession for sale by a person other than a distributor, and upon the use, consumption, and possession for use or consumption of cigarettes within this State at the rate set in G.S. 105-113.5. This tax does not apply, however, to cigarettes upon which the tax levied in G.S.105-113.5 has been paid.

Railroads operating interstate are permitted to sell cigarettes by the pack, but such carriers must procure permission from the Secretary to sell cigarettes and must report all sales made within North Carolina to the Department on or before the 20<sup>th</sup> day of each month. The reports must be filed on forms prescribed by the Secretary and must state the amount of non-tax-paid cigarettes sold on the train in this State during the immediately preceding month. A remittance of the excise tax due the State on such sales must be submitted with the report. Railroads wishing to file the reports on other than a calendar month schedule must obtain approval from the Secretary before doing so.

Non-tax-paid cigarettes may be sold for use or consumption by or on ocean-going vessels which leave the continental United States and which ply the high seas in interstate or foreign commerce in the transport of freight or passengers for hire exclusively when delivered to an officer or agent of such vessel for use by or on such vessel accordingly. Receipt for delivery of such non-tax-paid cigarettes shall be signed for by an authorized officer or agent of such vessel, and such signed receipts shall be retained by the distributor for a period of three years; also, a copy of same shall be appended to the appropriate monthly tax report of the distributor. Only North Carolina tax-paid cigarettes may be sold by such vessels while in port or within the territorial limits of this State.

**8. Tax on Inventory When Tax Rate Increases (G.S. 105-113.7)**

Every distributor subject to the taxes levied in this Article who, on the effective date of a tax increase under this Article, has on hand any cigarettes must file a complete inventory of the cigarettes within twenty (20) days after the effective date of the increase, and pay an additional tax to the Secretary when filing the inventory. The amount of tax due is the amount due based on the difference between the former tax rate and the increased tax rate.

**9. Federal Constitution and Statutes (G.S. 105-113.8)**

Any activities which this Article may purport to tax in violation of the Constitution of the United States or any federal statute are hereby expressly exempted from taxation under this Article.

Non-tax-paid cigarettes may be sold to the federal government and its instrumentalities, such as the Armed Forces Exchange Services, but sales by such services shall be limited to members of the armed forces and their dependents who hold identification cards entitling them to make purchases through armed forces exchange services.

Whenever deliveries of non-tax-paid cigarettes are made by distributors to armed forces exchange services, the person making such delivery shall have in his actual possession invoices for such cigarettes which shall show date, invoice number, name and address of distributor, and the name and address of the purchaser and the quantity and brands of cigarettes being transported. If these conditions are not complied with, the non-tax-paid cigarettes shall be subject to confiscation, and the distributor taxed on such sales or deliveries made in an unauthorized manner. In the event of such deliveries of non-tax-paid cigarettes, the cigarettes shall be physically delivered by the distributor's conveyance or a duly authorized common carrier directly to the situs where the installation of the governmental agency is located. Upon such delivery the distributor shall require a duly receipted invoice or copy thereof from the governmental agent designated to accepted delivery. Distributors shall have a bona fide bill of lading, if delivery is made by common carrier.

No sales of non-tax-paid cigarettes on military installations may be made through vending machines, other than those owned and operated by the federal government or instrumentalities thereof.

Members of the armed forces or their dependents authorized to purchase through armed forces exchange services cannot sell, offer for sale, or redistribute in any manner non-tax-paid cigarettes purchased on or through military installations. All such non-tax-paid cigarettes handled in violation of the cigarette law and its rules are subject to confiscation and the person(s) are subject to the tax, interest, and all penalties.

If a person engages in the sale of cigarettes on a military reservation, regardless of the fact that he may have a contract with the federal government, whereby the federal government will receive a commission, flat fee or some other type of compensation on such sales, same does not exempt the sale of such cigarettes from the cigarette excise tax. In such instance, such sales would not be made by the federal government or an instrumentality of the federal government. Instead, on all such sales, the cigarette tax is due.

#### **10. Out-of-state Shipments (G.S. 105-113.9)**

Any distributor engaged in interstate business is permitted to set aside part of the stock as necessary to conduct interstate business without paying the tax otherwise required by this Part, but only if the distributor complies with the requirements prescribed by the Secretary concerning keeping of records, making of reports, posting of bond, and other matters for administration of this Part.

“Interstate business” as used in this section means:

- The sale of cigarettes to a nonresident where the cigarettes are delivered by the distributor to the business location of the nonresident purchaser in another state;
- The sale of cigarettes to a nonresident wholesaler or retailer registered through the Secretary who has no place of business in North Carolina and who purchases the cigarettes for the purposes of resale not within this State and where the cigarettes are delivered to the purchaser at the business location in North Carolina of the distributor who is also licensed as a distributor under the laws of the state of the nonresident purchaser.

Only licensed North Carolina cigarette distributors may make out-of-state sales of non-tax-paid cigarettes to nonresident retail or wholesale cigarette dealers. Generally, these sales of non-tax-paid cigarettes by a licensed North Carolina distributor to nonresident retail or wholesale dealers must be delivered by the North Carolina distributor to the business location of the nonresident in another state to qualify as an out-of-state sale exempted from the North Carolina cigarette excise tax. However, a nonresident dealer may accept delivery of cigarette purchases in this State provided:

- The nonresident dealer has no place of business in North Carolina.
- The nonresident dealer is purchasing cigarettes for the purpose of resale outside on North Carolina.

- The nonresident dealer's cigarette purchases must have affixed thereto by the North Carolina distributor the tax-paid cigarette indicia of the state of the nonresident purchaser where required.

Cigarettes sold and delivered outside this state must have affixed thereto by the North Carolina cigarette distributor selling same the tax-paid cigarette indicia of the state of the nonresident purchaser where required.

Cigarette distributors, wholesalers, and retailers must comply with all applicable State and federal laws regarding the sale and distribution of cigarettes, such as the Federal Contraband Act, the Federal Jenkins Act, and all state and federal laws prohibiting the sale of cigarettes to minors.

#### **11. Manufacturers (G.S. 105-113.10)**

Manufacturers are required to forward the Secretary copies of all invoices, or equivalent information, of shipments of cigarettes to distributors, wholesalers or retail dealers in this State on a monthly basis, or at the time of shipment. An invoice is also required on gratis cigarettes by licensed distributors on behalf of the manufacturer.

No manufacturer may make shipments of cigarettes, including drop shipments, to any person in this State not qualified as a distributor without the manufacturer being licensed as a North Carolina cigarette distributor, keeping records, filing reports, and remitting tax as required.

The Secretary will permit the manufacturer to file monthly reports on complimentary cigarettes given by the manufacturer, which are not otherwise exempt under G.S. 105-113.5, when such packages of cigarettes have imprinted thereon the proper words reflecting that the cigarette excise tax has been paid. Remittance covering the cigarette tax must accompany the monthly report, which is due no later than the 20<sup>th</sup> day of the month following the close of the preceding month.

Any manufacturer shipping cigarettes to other distributors who are licensed under G.S. 105-113.12 may, upon application to the Secretary and upon compliance with requirements prescribed by the Secretary, be relieved of paying the taxes levied in this Part.

Manufacturers may also qualify as distributors under this Article, and set aside a portion of their stock of cigarettes accordingly for that purpose. Such inventory must be reported as required of all distributors under this Article. When a manufacturer qualifies as a distributor and makes shipments into North Carolina, the invoice must indicate payment of the excise tax by the wording, "North Carolina Cigarette Excise Tax Paid." A copy of each invoice or charge-out by the manufacturer to its distributor operation must be forwarded to the Department on a monthly basis accordingly.

#### **12. Licenses Required (G.S. 105-113.11)**

No person can legally engage in business as a distributor in this State, without having first obtained from the Secretary the appropriate license for that purpose as prescribed

herein. Any license required by this Article shall be in addition to any and all other licenses which may be required by law.

**13. Distributor Must Obtain License (G.S. 105-113.12)**

A distributor must obtain for each place of business a continuing distributor's license and pay a tax of twenty-five dollars (\$25.00) for the license. For the purposes of this section, a "place of business" is a place where a distributor receives or stores non-tax-paid cigarettes. An out-of-state distributor may obtain a distributor's license upon compliance with the provisions of G.S. 105-113.24 and payment of a tax of twenty-five dollars (\$25.00).

**14. Investigation of Applicant and Bond Requirement (G.S. 105-113.13)**

The Secretary may investigate an applicant for a distributor's license to determine if the information the applicant submits with the application is accurate and if the applicant is eligible to be licensed as a distributor. The Secretary may decline to issue a distributor's license to an applicant when the Secretary has reasonable cause to believe any of the following:

- That the applicant has willfully withheld information requested by the Secretary for the purpose of determining the applicant's eligibility for the license.
- That information submitted with the application is false or misleading.
- That the application is not made in good faith.

The Secretary may require a distributor to furnish a bond in an amount that adequately protects the State from loss if the distributor fails to pay taxes due under this Part. A bond is conditioned on compliance with this Part, is payable to the State, and must be in the form required by the Secretary. The Secretary sets the bond amount based on the anticipated tax liability of the distributor. The Secretary periodically reviews the sufficiency of bonds required of the distributor and may increase the amount of a required bond if the bond amount no longer covers the anticipated tax liability of the distributor. The Secretary may decrease the amount of a required bond if the Secretary finds that a lower bond amount will protect the State adequately from loss.

**15. Identification of Dispensers (G.S. 105-113.17)**

Each vending machine that dispenses cigarettes must be marked to identify its owner in the manner required by the Secretary.

Distributors, wholesalers or retail dealers owning, leasing, furnishing or operating cigarette vending machines shall affix to each such machine in a conspicuous place an identification sticker or device, which shall show the name, address and telephone number of the operator owning and placing such machine on location. The owner of the business wherein such machine is located shall also be responsible for seeing that such vending machine is so identified. No cigarette-dispensing machine is allowed to operate in this State that does not have affixed thereto the identification required under G.S.105-113.17.

It is the duty of any person, firm or corporation operating cigarette vending machines to have available for the Department information as to the location of any and all vending machines so operated by such operator and make such information available at any time to the secretary or his authorized agent.

**16. Payment of Tax and Required Reports (G.S. 105-113.18)**

The taxes levied in this Part are payable when a report is required to be filed. The following reports are required to be filed with the Secretary:

**a. Distributor's Report**

A distributor is required to file a monthly report in the form prescribed by the Secretary. The report covers sales and other activities occurring in a calendar month and is due within twenty (20) days after the end of the month covered by the report. The report must state the amount of tax due and identify any transactions to which the tax does not apply. Every licensed resident distributor must file a report, Form B-A-5, on or before the 20<sup>th</sup> day of each month. Non-tax-paid cigarettes shipped, delivered, or sold outside the State during the month must be reported on supplemental Form B-A-5, Schedule I. Tax-paid cigarettes sold outside the state must be reported on Schedule D, line 7. Cigarettes returned to the manufacturer during the month must be reported on supplemental Form B-A-5, Schedule J. Every licensed nonresident distributor must file a report, Form B-A-6 on or before the 20<sup>th</sup> day of each month. Any licensed resident or nonresident distributor wishing to file the report or the form on other than a calendar month schedule must obtain approval from the Secretary before doing so.

**b. Report of Free Cigarettes**

A manufacturer who distributes cigarettes without charge must file a monthly report in the form prescribed by the Secretary. The report covers cigarettes distributed without charge in a calendar month and is due within twenty (20) days after the end of the month covered by the report. The report must state the number of cigarettes distributed without charge and the amount of tax due.

**c. Use Tax Report**

Every other person who has acquired non-tax-paid cigarettes for sale, use, or consumption subject to the tax imposed by this Part must, within ninety-six (96) hours after receipt of the cigarettes, file a report in the form prescribed by the Secretary showing the amount of cigarettes so received and any other information required by the Secretary. The report must be accompanied by payment of the full amount of the tax.

**d. Shipping Report**

Any person, except a licensed distributor, who transports cigarettes upon the public highways, roads, or streets of this State, upon notice from the Secretary, must file a report in the form prescribed by the Secretary containing the information required by the Secretary.

**17. Discount; Refund (G.S. 105-113.21)**

A distributor is allowed to deduct a discount equal to two percent (2%) of the tax due if the report is filed and the tax due is paid by the due date. The discount covers expenses incurred in preparing the records and reports required by this Part and the expense of furnishing a bond.

A distributor in possession of packages of stale or otherwise unsalable cigarettes upon which the tax has been paid may return the cigarettes to the manufacturer and apply to the Secretary for refund of the tax, less the discount allowed. The application shall be in the form prescribed by the Secretary and shall be accompanied by an affidavit from the manufacturer stating the number of cigarettes returned to the manufacturer by the applicant.

Any spoiled packages of tax-paid cigarettes in the hands of a retailer or wholesaler should be returned to its respective distributors, as refunds of the cigarette excise tax will be made only to the distributor.

A distributor may not receive a refund of taxes paid on tax-paid cigarettes subsequently sold outside this State nor may the distributor include the number of tax-paid cigarettes sold outside this State on page 1, schedule A, line 6.

**18. Registration of Out-of-state Distributors and Tax Remittance (G.S. 105-113.24)**

The Secretary may authorize any distributor outside this State engaged in the business of selling and shipping cigarettes into the State to obtain a license and report and pay taxes required by this Part.

A nonresident distributor must agree to submit the distributor's books, accounts, and records to reasonable examination by the Secretary or the Secretary's duly authorized agents. Any nonresident distributor applying for a license as a North Carolina distributor who does not have any located place of business in the State from which such business is being conducted will be required by the Secretary to post a bond as provided for under G.S. 105-113.13, before such nonresident license is issued. The minimum bond amount will be five thousand dollars (\$5,000).

Each such nonresident distributor, other than a foreign corporation which has qualified with the Secretary of State as doing business in this State shall, by a duly executed instrument filed in the office of the Secretary of State, constitute and appoint the Secretary of State his lawful attorney in fact upon whom any original process in any action or legal proceeding against such nonresident distributor arising out of any matter relating to this Article may be served, and therein agree that any original process against him so served shall be of the same force and effect as if served on him within this State, and that the authority thereof shall continue in force irrevocably so long as any such nonresident distributor shall remain liable for any taxes, interest and penalties under this Article.

Any nonresident distributor who shall comply with the provisions of this section may be licensed as a distributor.

**19. Reports and Records (G.S. 105-113.26, G.S. 105-113.30)**

Every licensed distributor must file a report on or before the 20<sup>th</sup> day of each month with tax remittance on the form prescribed by the Secretary showing transactions for the preceding month, and such other information as required by the report. Monthly reports are required whether or not any tax is shown to be due. Each licensed distributor wishing to file the report on other than a calendar month schedule must obtain approval from the Secretary before doing so.

Distributors who operate in a period, other than a calendar month, must provide the Tobacco Products Excise Tax Unit of the Department a list of the period ending dates for each coming year. This period ending schedule is due in November of each year unless advised otherwise. The cigarette monthly report is due within twenty (20) days after the particular period ends.

Every person required to be licensed under this Article and every person required to make reports under this Article shall keep complete and accurate records of all sales and other information as required under this Article. The records shall be in the form prescribed by the Secretary. These records shall be safely preserved for a period of three years in a manner to ensure their security and accessibility for inspection by the Department. The Secretary may consent to the destruction of any records at any time within this three-year period.

It is unlawful for any person who is required under the provisions of this Article to keep records or make reports, to fail to keep such records, refuse to keep such reports, make false entries in such records, fail to produce such records for inspection by the Secretary or his duly authorized agents, fail to file a report, or make a false or fraudulent report or statement.

Each sale of cigarettes at wholesale, including cash and credit transactions, and regardless of whether the sale is made to another distributor, wholesale dealer, retail dealer, or is a transfer to a self-owned outlet or an agency or agent, must be accompanied by a completed invoice indicating the person to whom the cigarettes were sold, the address of the purchaser, the date of the sale, the quantity sold, and the price charged.

Sales invoices of distributors, whether resident or nonresident, must indicate payment of the excise tax by the wording, "North Carolina Cigarette Excise Tax Paid."

If a distributor is also a retail dealer and sells cigarettes to consumers, an invoice or a memorandum must be prepared showing the transfer of all cigarettes from the distributor to the retail activity. Cigarette excise tax is applicable at the point of transfer and the required documents must reflect payment of the tax by the wording, "North Carolina Cigarette Excise Tax Paid."

**20. Non-tax-paid Cigarettes (G.S. 105-113.27)**

Except as otherwise provided in this Article, no person may legally possess non-tax-paid cigarettes in this State. Only licensed distributors may receive non-tax-paid

cigarettes. Licensed distributors are not allowed to sell, borrow, loan, or exchange non-tax-paid cigarettes to, from, or with other licensed distributors. Under no circumstances may non-tax-paid cigarettes be sold in North Carolina.

The possession of more than six hundred (600) cigarettes on which tax has been paid to another state or country, by any person other than a licensed distributor, is prima facie evidence that the cigarettes are possessed in violation of this Part.

**21. Unlicensed Place of Business (G.S. 105-113.29)**

It is unlawful for any person to maintain a place of business within this State required by this Article to be licensed to engage in the business of selling or offering for sale cigarettes without first obtaining such licenses.

**22. Possession and Transportation of Non-tax-paid Cigarettes (G.S. 105-113.31)**

It is unlawful for any person to transport non-tax-paid cigarettes in violation of this Part. The Secretary may adopt rules allowing quantities of non-tax-paid cigarettes, not exceeding six hundred (600), to be brought into this State by a transient, a tourist, or a person returning to this State after traveling outside this State, for their own use. The possession or transportation of these cigarettes is not subject to the penalties imposed by this section.

Every person who transports non-tax-paid cigarettes on the public highways, roads, streets, or waterways of this State must transport with the cigarettes invoices or delivery tickets for the cigarettes showing the true name and complete and exact address of the consignee or purchaser, the quantity and brands of the cigarettes transported, and the true name and complete and exact address of the person who has paid or who will pay the tax imposed by this Part or the tax, if any, of the state or foreign country at the point of ultimate destination.

A common carrier that has issued a bill of lading for a shipment of cigarettes and is without notice to itself or to any of its agents or employees that the cigarettes are non-tax-paid in violation of this Part is considered to have complied with this Part and the vehicle or vessel in which the cigarettes are being transported is not subject to confiscation under this section. In the absence of the required invoices, delivery tickets, or bills of lading, the cigarettes so transported, the vehicle or vessel in which the cigarettes are being transported, and any paraphernalia or devices used in connection with the non-tax-paid cigarettes are declared to be contraband goods and may be seized by any officer of the law, who shall take possession of the vehicle or vessel and cigarettes and shall arrest any person in charge of the vehicle or vessel and cigarettes.

The officer shall at once proceed against the person arrested, under the provisions of this Part, in any court having competent jurisdiction; but the vehicle or vessel shall be returned to the owner upon execution by the owner of a good and valid bond, with sufficient sureties, in a sum double the value of the property, which bond shall be approved by the officer and shall be conditioned to return the property to the custody

of the officer on the day of trial to abide the judgment of the court. All non-tax-paid cigarettes seized under this section shall be held and shall, upon the acquittal of the person so charged, be returned to the established owner.

Unless the claimant can show that the non-tax-paid cigarettes seized were not transported in violation of this Part and that the property seized belongs to the claimant or that in the case of property other than cigarettes, the property was used in transporting non-tax-paid cigarettes in violation of this Part without the claimant's knowledge or consent, with the right on the part of the claimant to have a jury pass upon this claim, the court shall order a sale by public auction of the property seized, and the officer making the sale, after deducting the cost of the tax due, which the officer shall pay upon sale, expenses of keeping the property, the fee for the seizure, and the costs of the sale, shall pay all liens according to their priorities, which are established, by intervention or otherwise, at the hearing or in another proceeding brought for the purpose as being bona fide and as having been created without the lien or having any notice that the vehicle or vessel was being used for the unlawful transportation of non-tax-paid cigarettes, and shall pay the balance of the proceeds to the State Treasurer for the General Fund.

All liens against property sold under the provisions of this section shall be transferred from the property to the proceeds of the sale of the property. If, however, no one is found claiming the cigarettes, or the vehicle or vessel, then the taking of the cigarettes, vehicle, or vessel, along with a description, shall be advertised in a newspaper having circulation in the county where the items were taken, once a week for two weeks and by notices posted in three public places near the place of seizure, and if no claimant appears within ten days after the last publication of the advertisement, the property shall be sold, and the proceeds, after deducting the expenses and costs, shall be paid to the State Treasurer for the General Fund.

This section does not authorize an officer to search any vehicle or vessel or baggage of any person without a search warrant duly issued, except where the officer has knowledge that there are non-tax-paid cigarettes in the vehicle or vessel.

### **23. Non-tax-paid Cigarettes Subject to Confiscation (G.S. 105-113.32)**

All non-tax-paid cigarettes subject to the tax imposed by this Part, together with any container in which they are stored or displayed for sale (including but not limited to vending machines), are declared to be contraband goods and may be seized by any officer of the law. The officer shall arrest any person in charge of the contraband goods and shall at once proceed against the person arrested, under the provisions of this Part, in any court having competent jurisdiction. The disposition of the seized cigarettes and container are governed by the provisions of G.S. 105-113.31.

### **24. Criminal Penalties (G.S. 105-113.33)**

Any person who violates any of the provisions of this Article for which no other punishment is specifically prescribed shall be guilty of a Class 1 misdemeanor.

## **25. Tax on Tobacco Products Other Than Cigarettes (G.S. 105-113.35)**

An excise tax is levied on tobacco products other than cigarettes at the rate of ten percent (10%) of the cost price of the products. "Cost price" means the actual gross purchase price of the other tobacco products before any discounts, rebates, or allowances and before the excise tax is applied. Additional charges which are included and are not set out separately on the invoice, such as freight charges that are not separately stated, are considered part of the cost price and the tax is applied to the total invoice amount before any deductions.

This tax does not apply to the following:

- A tobacco product sold outside the State.
- A tobacco product sold to the federal government.
- A sample tobacco product distributed without charge.

The wholesale dealer or retail dealer who first acquires or otherwise handles other tobacco products subject to the tax imposed by this section is liable for the tax imposed by this section. A wholesale dealer or retail dealer who brings into this State a tobacco product made outside the State is the first person to handle the tobacco product in this State. A wholesale dealer or retail dealer who is the original consignee of a tobacco product that is made outside the State and is shipped into the State is the first person to handle the tobacco product in this State.

Examples are:

- The out-of-state wholesale dealer or retail dealer who brings such products into the State on its own truck.
- The in-state wholesale dealer or retail dealer who brings such products into the State on its own truck.
- The in-state wholesale dealer or retail dealer who first receives such products from outside the State by common carrier or contract carrier.

A retail dealer who acquires non-tax-paid other tobacco products subject to the tax imposed by this section from a wholesale dealer is liable for any tax due on the tobacco products. A retail dealer who is liable for tax under this subsection may not deduct a discount from the amount of tax due when reporting the tax.

A manufacturer who is not a retail dealer and who ships tobacco products other than cigarettes to either a wholesale dealer or retail dealer licensed under this Part may apply to the Secretary to be relieved of paying the tax imposed by this section on the tobacco products. Once granted permission, a manufacturer may choose not to pay the tax until otherwise notified by the Secretary. To be relieved of payment of the tax imposed by this section, a manufacturer must comply with the requirements set by the Secretary.

Effective October 1, 2007, permission granted to a manufacturer to be relieved of paying the tax also applies to an integrated wholesale dealer with whom the manufacturer is an affiliate. A manufacturer must notify the Secretary of any integrated wholesale dealer with whom it is an affiliate when the manufacturer applies to the Secretary to be relieved of paying the tax and when an integrated wholesale dealer becomes an affiliate of the manufacturer after the Secretary has given the manufacturer permission to be relieved of paying the tax.

If a person is both a manufacturer of cigarettes and a wholesale dealer of tobacco products other than cigarettes and the person is granted permission under G.S. 105-113.10 to be relieved of paying the cigarette excise tax, the permission also applies to the tax imposed on tobacco products other than cigarettes. A cigarette manufacturer who becomes a wholesale dealer after receiving permission to be relieved of the cigarette excise tax must notify the Secretary of the permission received under G.S. 105-113.10 when applying for a license as a wholesale dealer.

Other tobacco products sold to the federal government and its instrumentalities, such as the Armed Forces Exchange Services, are exempt from the excise tax. However, to qualify for exemption, sales of other tobacco products by such services must be limited to members of the armed forces and their dependents who hold identification cards entitling them to make purchases through armed forces exchange services.

Whenever tax-exempt deliveries of other tobacco products are made by dealers to armed forces exchange services, the dealer must require a duly receipted invoice or copy thereof from the governmental agent designated to accept delivery.

If a person engages in the sale of any other tobacco products on a military reservation, regardless of the fact that he may have a contract with the federal government, whereby the federal government will receive a commission, flat fee, or some other type of compensation on such sales, same does not exempt the sale of such products from the excise tax. In such instances, such sales would not be made by the federal government or an instrumentality thereof. Instead, all such sales are subject to the excise tax.

## **26. Manufacturers of Other Tobacco Products (G.S. 105-113.35)**

No manufacturer may make shipments of other tobacco products directly to a person in this State not qualified and licensed as a wholesale or retail dealer of other tobacco products.

Any manufacturer of other tobacco products shipping such products to other wholesale or retail dealers who are licensed pursuant to G.S. 105-113.36 for payment of the other tobacco products excise tax is relieved of the requirement of paying tax.

A retail dealer who manufactures other tobacco products and sells those products to consumers in this State is liable for the tax except for those transactions in other tobacco products which meet exemption from the tax under G.S. 105.113.35.

**27. Wholesale Dealer and Retail Dealer Must Obtain License (G.S. 105-113.36)**

Wholesale dealers and retail dealers, liable for excise tax on other tobacco products under G.S. 105-113.35, must obtain a continuing Other Tobacco Products Tax License for each place of business. "Place of business" means any place where a wholesale dealer or a retail dealer makes tobacco products other than cigarettes or a wholesale dealer or a retail dealer receives or stores non-tax-paid tobacco products other than cigarettes.

The application for each license must be on a form prescribed by the Secretary and the appropriate license tax, twenty-five dollars (\$25) for wholesale dealers and ten dollars (\$10) for retail dealers, must accompany the application form.

The application for license must be signed and verified by oath or affirmation by the owner, if an natural person, and in the case of an association or partnership, by a member or partner thereof, and in the case of a corporation, by an executive officer thereof or by any person specifically authorized by the corporation to sign the application to which shall be attached the written evidence of his authority.

The licensee must notify the Secretary in writing of any changes in the information previously provided on the license application as such changes occur. Additionally, the licensee is responsible for notifying the manufacturers from whom other tobacco products are purchased or received of the other tobacco products license issued by the Secretary and of any subsequent change relative to the license.

The license is not assignable or transferable and the license tax is not prorated.

**28. Payment of Tax (G.S. 105-113.37)**

Except for tax on sales designated as tax-exempt under G.S. 105-113.35, the taxes levied by this Article are payable when a report is required to be filed. Monthly reports covering sales and other activities occurring in a calendar month are due within twenty (20) days after the end of the month covered by the report. Each report must be filed on a form provided by the Secretary and must contain the information required by the Secretary. A return must be filed each month even if no tax is due for that month. Any wholesale dealer selling designated other tobacco products wishing to report sales and other activities occurring in the report period on other than a calendar month schedule must obtain approval from the Secretary before doing so.

Wholesale dealers and retail dealers who operate in a period other than a calendar month, must provide the Tobacco Products Excise Tax Unit of the Department a list of the period ending dates for each coming year. This period ending schedule is due in November of each year unless advised otherwise. The other tobacco products monthly report and tax remittance are due within twenty (20) days after the particular period ends.

Sales invoices of wholesale dealers, whether resident or nonresident, liable for the tax must indicate payment of the excise tax on other tobacco products by the wording "North Carolina Other Tobacco Products Tax Paid."

All sales invoices of nonresident wholesale dealers must show the point of origin and mode of transportation for all shipments of other tobacco products into this State.

A wholesale dealer who sells a tobacco product to a person who has notified the wholesale dealer in writing that the person intends to resell the item in a transaction that is exempt from tax under G.S. 105-113.35(a)(1) or (2) may, when filing a monthly report, designate the quantity of tobacco products sold to the person for resale. A wholesale dealer must report all designated sales during a taxable period on Form B-A-101. The wholesale dealer must separately invoice and indicate the other tobacco products designated for exempt transactions. For example, sales designated for customers with other tobacco product sales outside North Carolina must be invoiced to read, "Designated for Sale Outside North Carolina". A wholesale dealer is not required to pay tax on a designated sale when filing a monthly report. However, where prior written notification is not provided, the wholesale dealer must remit applicable tax.

The wholesale dealer must pay the tax due on all other sales in accordance with this section. A wholesale dealer or a customer of a wholesale dealer may not delay payment of the tax due on a tobacco product by failing to pay tax on a sale that is not a designated sale or by overstating the quantity of tobacco products that will be resold in a transaction exempt under G.S. 105-113.35(a)(1) or (2).

A person who does not sell a tobacco product in a transaction exempt under G.S. 105-113.35(a)(1) or (2) after a wholesale dealer has failed to pay the tax due on the sale of the item to the person in reliance on the person's written notification of intent is liable for the tax and any penalties and interest due on the designated sale. If the Secretary determines that a tobacco product reported as a designated sale is not sold as reported, the Secretary will assess the person who notified the wholesale dealer of an intention to resell the item in an exempt transaction for the tax due on the sale and any applicable penalties and interest. A wholesale dealer who does not pay tax on a tobacco product in reliance on a person's written notification of intent to resell the item in an exempt transaction is not liable for any tax assessed on the item.

The tax liability plus penalties and interest will be held against the wholesaler's customer who sells other tobacco products designated exempt in a taxable transaction. Customers violating designation procedures can expect full penalties to be held on designated products improperly handled.

Once other tobacco products are designated as tax exempt under G.S. 105-113.35, they must be sold in tax-exempt transactions.

## **29. Bond (G.S. 105-113.38)**

The Secretary requires a wholesale dealer or a retail dealer to furnish a bond in an amount that adequately protects the State from loss if the dealer fails to pay taxes due under Part 3 of the Tobacco Products Tax Act. A bond must be conditioned on compliance with this Part, must be payable to the State, and must be in the form

required by the Secretary. The Secretary will proportion a bond amount to the anticipated tax liability of the wholesale dealer or retail dealer. The Secretary will periodically review the sufficiency of bonds required of dealers, and will increase the amount of a required bond when the amount of the bond furnished no longer covers the anticipated tax liability of the wholesale dealer or retail dealer. The Secretary will decrease the amount of a required bond when the Secretary determines that a smaller bond amount will adequately protect the State from loss.

**30. Discount; Refund (G.S. 105-113.39)**

A wholesale dealer or a retail dealer who is primarily liable for the taxes imposed by this Part is allowed to deduct a discount equal to two percent (2%) of the tax due if the report is filed and the tax due is paid by the due date. The discount covers losses due to damage to tobacco products, expenses incurred in preparing the records and reports required by this Part, and the expense of furnishing a bond.

A wholesale dealer or a retail dealer who is primarily liable for the excise tax and is in possession of stale or otherwise unsalable cigars upon which the tax has been paid may return the cigars to the manufacturer and apply to the Secretary for refund of tax paid, less any discount allowed on the unsalable cigars. The application must be in the form prescribed by the Secretary and must be accompanied by an affidavit from the manufacturer stating the number of cigars returned to the manufacturer by the applicant.

**31. Records (G.S. 105-113.40)**

Every wholesale dealer, every retail dealer and their customers must keep accurate records of inventories, purchases, and sales of tobacco products for at least three years. These records and inventories must be maintained separately in such a manner as can be inspected and audited by the Secretary or duly authorized representative at any time without having to go through and separate or segregate all sales of the taxpayer in order to arrive at the amount of exempt sales or inventories. These records must be open at all times for inspection by the Secretary or an authorized representative of the Secretary.

**32. Other Tobacco Products Vending Machines**

No other tobacco products dispensing machine will be allowed to operate in this State that does not have affixed thereto the identification required under the Tobacco Products Tax Article.

Wholesale dealers or retail dealers owning, leasing, furnishing or operating other tobacco products vending machines must affix to each machine in a conspicuous place an identification sticker or device, which shows the name, address and telephone number of the operator owning and placing such machine on location. The owner of the business wherein such machine is located is also responsible for seeing that such vending machine is so identified.

It is the duty of any person, firm or corporation operating other tobacco products vending machines to have available for the Department information as to the location

of any and all vending machines so operated by such operator, and make such information available at any time to the Secretary or his authorized agent.

### **33. Refund of Overpaid Tax**

A wholesale dealer or a retail dealer who pays tax to the Department on other tobacco products that are exempt from the excise tax may obtain a refund for the net amount of tax paid by filing an application for refund form provided by the Secretary. Applications for refund must be submitted within the time allowed by G.S. 105-241.6.

### **34. Interest and Penalties (G.S. 105-236, G.S. 105-241.21)**

Interest, at the rate set by the Secretary, is applicable to all late payments of the tobacco products excise tax and to all assessments of additional tax due.

The North Carolina Statutes provide both civil and criminal penalties for failure to comply with the tax laws. See Section VIII General Administration for additional information. Also, see Item 24 above for information on penalties specific to this Article.

## **B. Alcoholic Beverage License and Excise Tax (G.S. 105-113.68 – G.S. 105-113.89)**

### **1. Excise Tax on Beer, Wine, and Liquor (G.S. 105-113.68(b))**

#### **a. Levy of Tax**

An excise tax is levied on all alcoholic beverages sold in and/or shipped into this State unless the exemptions provided in G.S. 105-131.81 apply. This excise tax also applies to wine sold and shipped by holders of ABC-issued wine shipper permits.

The excise taxes on malt beverages and wine are payable by the resident wholesaler or importer who first handles the beverages in this State since the tax is levied only once on the same beverages.

#### **b. Wine Shipper Permittees**

Wine shipper permittees (resident and nonresident wineries that hold the required ABC permits) may sell and ship not more than two cases of wine per month to any person in North Carolina to whom alcoholic beverages may be sold. All sales and shipments must be for personal use only and not for resale. A case of wine is defined as any combination of packages containing not more than nine liters of wine. Each wine shipper permittee is responsible for the excise tax on wine levied under G. S. 105-113.80(b).

### **2. Tax Rates (G.S. 105-113.80)**

The tax rates on beer, wine, and liquor are:

- a. Beer** – fifty-three and one hundred seventy-seven one thousandths cents (53.177¢) per gallon.
- b. Wine** – twenty-one cents (21¢) per liter of unfortified wine and twenty-four cents (24¢) per liter of fortified wine.

- c. **Liquor** – twenty-five percent (25%) on liquor sold in ABC stores. The tax is computed on the distiller’s price plus the state ABC warehouse freight and bailment charges and a markup for local ABC boards.

**3. Exemptions (G.S. 105-113.81)**

**a. Major Disaster (G.S. 105-113.81(a), 17 NCAC 04E.0205)**

Wholesalers and importers of malt beverages and wine are not required to remit excise taxes on malt beverages or wine rendered unsalable by a major disaster.

Losses from a “major disaster” as defined in G.S. 105-113.81(a) must be verified by an agent of the Department of Revenue and Form B-C-750 must be completed before the losses can be claimed by the wholesaler or importer on his monthly report. Several small disasters cannot be accumulated and then classified as a major disaster. A major disaster is classified as one event only in which such loss occurs, and not an accumulation of events. Any missing beverage inventory that cannot be classified as a major disaster will be considered as beer or wine sold and subject to the excise tax accordingly, unless otherwise provided.

**b. Spoilage or Destruction of Non-tax-paid Beer or Wine (17 NCAC 04E.0301)**

Where the spoilage, breakage, or destruction of non-tax-paid beer or wine in the inventory of the resident wholesaler or importer is a lesser amount than that defined as a “major disaster” in G.S. 105-113.81(a), there shall be no deduction from the excise tax as compensation for such loss.

**c. Spoilage of Tax-paid Beer or Wine (17 NCAC 04E.0302)**

Spoilage, breakage, or other losses of any tax-paid beer or wine may not be claimed as a deduction from the excise tax due.

**d. Destruction When in Transit (17 NCAC 04E.0303)**

Destruction of non-tax-paid beer or wine in transit from the brewery or winery to the resident wholesaler or importer when such beer or wine is in the hands of the common carrier, even though such common carrier may be considered as the agent of the resident wholesaler or importer, and when such beer or wine is accounted for by the common carrier by payment of such beverage loss to the resident wholesaler or importer, will not be considered as part of the taxable inventory of the resident wholesaler or importer, and thus not subject to the beverage excise tax.

**e. Sales to Oceangoing Vessels (G.S. 105-113.81(b), 17 NCAC 04E.0502)**

Wholesalers and importers of malt beverages and wine are not required to remit excise taxes on malt beverages and wine sold and delivered for use on oceangoing vessels. An oceangoing vessel is a ship that plies the high seas in interstate or foreign commerce, in the transport of freight or passengers, or both, for hire exclusively. To qualify for this exemption the beverages must be delivered to an officer or agent of the vessel for use on that vessel. Sales made to officers, agents, crewmen, or passengers for their personal use are not exempt. Receipt for delivery of non-tax-paid beer to ocean-going vessels must be signed for by an authorized officer or

agent of such vessel, and such signed receipts must be retained by the wholesaler for a period of three years.

**f. Sales to Armed Forces (G.S. 105-113.81(c))**

Wholesalers and importers are not required to remit excise taxes on malt beverages and wine sold to the United States Armed Forces. The Secretary may require malt beverages and wine sold to the Armed Forces to be marked “For Military Use Only” to facilitate identification of those beverages.

**g. Out-of-State Sales (G.S. 105-113.81(d), 17 NCAC 004E.0204)**

Wholesalers and importers are not required to remit excise taxes on malt beverages and wine shipped out of this State for resale outside the State. Records of out-of-state shipments by the resident wholesaler or importer must be maintained that can be properly checked by the Secretary of Revenue, and bills of lading must also be kept on such out-of-state shipments. If delivered by the wholesaler’s or importer’s own truck, the signature, address and social security number of the person receiving beer or wine from the wholesaler or importer must be kept for verification by the secretary. Such sales must be imported on the monthly report form in the space provided.

**h. Tasting (G.S. 105-113.81(e))**

Resident breweries and wineries are not required to remit excise taxes on malt beverages and wine given free of charge to customers, visitors, and employees on the manufacturer’s licensed premises for consumption on those premises.

**4. Payment of Excise Tax (G.S. 105-113.83)**

**a. Beer and Wine (G.S. 105-113.83(b))**

The excise taxes on malt beverages and wine are payable to the Secretary by the resident wholesaler or importer who first handles the beverages in this State. The taxes on malt beverages and wine are levied only once on the same beverages.

The excise tax levied under G.S. 105-113.80(b) on wine shipped directly to consumers in North Carolina pursuant to G.S. 18B-1001.1 must be paid by the wine shipper permittee.

The tax must be paid on or before the 15<sup>th</sup> day of the month following the month in which the beverage is first sold or otherwise disposed of in this State by the wholesaler, importer, or wine shipper permittee.

When excise taxes are paid on wine or malt beverages, the wholesaler, importer, or wine shipper permittee must submit to the Secretary verified reports on forms provided by the Secretary detailing sales records for the month for which the taxes are paid. The report must indicate the amount of excise tax due, indicate separately any transactions to which the excise tax does not apply, and include all the information required by the Secretary.

**b. Liquor (G.S. 105-113.83(a))**

The excise tax on liquor is payable monthly by the local ABC board to the Secretary. The tax is due on or before the 15<sup>th</sup> day of the month following the month in which the tax was collected.

**c. Railroad Sales (G.S. 105-113.83(c))**

Each person operating a railroad train in this State on which alcoholic beverages are sold must submit monthly reports of the amount of alcoholic beverages sold in this State and must remit the applicable excise tax due on the sale of these beverages when the report is submitted. The report is due on or before the 15<sup>th</sup> day of the month following the month in which the beverages are sold. The report must be made on a form prescribed by the Secretary.

**d. Wholesaler Buying From Wholesaler (17 NCAC 04E.0206)**

When a resident wholesaler or importer purchases beer or wine from another wholesaler or importer in this state, the beverages must be reported separately as tax-paid beverages in the space provided on the monthly report filed by the purchasing resident wholesaler or importer since the selling resident wholesaler or importer, being the first in the State to receive or handle the product, is liable for the tax and must include the same product in their monthly report and pay the tax due.

**5. Reports (G.S. 105-113.84)**

A resident brewery, resident winery, nonresident vendor, and wine shipper permittee must file a monthly report with the Secretary. The report must list the amount of beverages delivered to North Carolina wholesalers, importers, and purchasers under G.S. 18B-1001.1 during the month. The report is due by the 15<sup>th</sup> day of the month following the month covered by the report. The report must be filed on a form approved by the Secretary and must contain the information required by the Secretary.

**6. Discount (G.S. 105-113.85)**

Each wholesaler or importer is allowed to deduct a discount equal to two percent (2%) of the tax due if the report is filed and the tax due is paid by the due date. The discount covers the losses due to spoilage and breakage, expenses incurred in preparing the records and reports required by this Article, and the expenses of furnishing a bond.

**7. Bonds (G.S. 105-113.86)**

**a. Wholesalers and Importers (G.S. 105-113.86(a), 17 NCAC 04E.0601)**

A resident wholesaler and importer must furnish a bond in an amount of at least five thousand dollars (\$5,000) and not more than fifty thousand dollars (\$50,000). The bond must be payable to the State, must be in a form acceptable to the Secretary, and must be secured by a corporate surety or by a pledge of obligations of the federal government, the State, or a political subdivision of the State. The bond amount is in proportion to the anticipated tax liability of the wholesaler or importer and may vary yearly, based upon a review by the Alcoholic Beverages Excise Tax

Unit of the wholesaler's or importer's tax payments during the best three months of the previous twelve-month period. Bond requirements are as follows:

- Where the combined tax due for any three months of the previous twelve months exceeds forty thousand dollars (\$40,000), the amount of the bond will be fifty thousand dollars (\$50,000).
- Where the combined tax due for any three months of the previous twelve months exceeds twenty-five thousand dollars (\$25,000), but does not exceed forty thousand dollars (\$40,000), the amount of the bond will be forty thousand dollars (\$40,000).
- Where the combined tax due for any three months of the previous twelve months exceeds twelve thousand five hundred dollars (\$12,500), but does not exceed twenty-five thousand dollars (\$25,000), the amount of the bond will be twenty-five thousand dollars (\$25,000).
- Where the combined tax due for any three months of the previous twelve months exceeds five thousand dollars (\$5,000), but does not exceed twelve thousand five hundred dollars (\$12,500), the amount of the bond will be twelve thousand five hundred dollars (\$12,500).
- Where the combined tax due for any three months of the previous twelve months does not exceed five thousand (\$5,000), the amount of the bond will be five thousand (\$5,000).

**b. New Wholesaler or Importer Bond (17 NCAC 04E.0602)**

In the case of a new wholesaler subject to the excise tax, or where operation has been conducted for less than twelve months prior to January 1, the amount of the bond is determined by the Secretary for the remainder of the calendar year or the ensuing calendar year based upon the wholesaler's anticipated business volume as evident by inventory, but will not be less than five thousand dollars (\$5,000).

**c. Nonresident Vendors (G.S. 105-113.86(b))**

The Secretary requires the holder of a nonresident vendor ABC permit to furnish a bond in an amount not to exceed two thousand dollars (\$2,000). The bond must be payable to the State, must be in a form acceptable to the Secretary, and must be secured by a corporate surety or by a pledge of obligations of the federal government, the State, or a political subdivision of the State.

**8. Refund of Excise Tax Paid on Sacramental Wine (G.S. 105-113.87)**

A person who purchases unfortified or fortified wine for the purpose stated in G.S. 18B-103(8) may obtain a refund from the Secretary for the amount of the excise tax levied under this Article. An applicant for a refund must file a written request for the refund due for the prior calendar year on or before April 15. Refunds are made annually. No refund will be made if the application is filed more than three years after the date it is due.

**9. Records (G.S. 105-113.88)**

A person who is required to file a report or return under this Article must keep a record of all documents used to determine information the person provides in a report

or return. The records must be kept for three years from the due date of the report or return to which the records apply.

### **C. Piped Natural Gas Excise Tax (G.S. 105-187.41)**

#### **1. Basis for Taxation**

An excise tax is imposed on piped natural gas received for consumption in this State. This tax is in lieu of the three percent (3%) sales tax and the three and twenty-two hundredths percent (3.22%) franchise gross receipts tax on piped natural gas. The tax is computed on a monthly therm volume of piped natural gas received by the end-user with a declining block rate structure as follows:

<u>Monthly Volume of Therms Received</u>	<u>Rate per Therm</u>
First 200 therms	\$0.047
201 – 15,000 therms	0.035
15,001 – 60,000 therms	0.024
60,001 – 500,000 therms	0.015
Over 500,000 therms	0.003

The excise tax on piped natural gas received by a manufacturer for use in connection with the operation of a manufacturing facility or by a farmer to be used for any farming purpose other than preparing food, heating dwellings, and other household purposes is being phased out. To qualify, a taxpayer must have a manufacturer's certificate or a farmer's certificate issued under G.S. 105-164.28A.

Rates per therm of natural gas received by a qualifying manufacturer or farmer for bills issued on or after October 1, 2007 and before July 1, 2008 are:

<u>Monthly Volume of Therms Received</u>	<u>Rate per Therm</u>
First 200 therms	\$0.032
201 – 15,000 therms	0.024
15,001 – 60,000 therms	0.016
60,001 – 500,000 therms	0.010
Over 500,000 therms	0.002

Rates per therm of natural gas received by a qualifying manufacturer or farmer for bills issued on or after July 1, 2008 and before July 1, 2009 are:

<u>Monthly Volume of Therms Received</u>	<u>Rate per Therm</u>
First 200 therms	\$0.025
201 – 15,000 therms	0.019
15,001 – 60,000 therms	0.013
60,001 – 500,000 therms	0.008
Over 500,000 therms	0.002

Rates per therm of natural gas received by a qualifying manufacturer or farmer for bills issued on or after July 1, 2009 and before July 1, 2010 are:

<u>Monthly Volume of Therms Received</u>	<u>Rate per Therm</u>
First 200 therms	\$0.014
201 – 15,000 therms	0.010
15,001 – 60,000 therms	0.007
60,001 – 500,000 therms	0.004
Over 500,000 therms	0.001

Qualifying manufacturers or farmers are exempt from the excise tax on piped natural gas for bills issued on or after July 1, 2010.

## **2. Who is Subject to Tax?**

The tax on piped natural gas delivered by a local distribution company to a sales or transportation customer is payable by the local distribution company.

The tax on piped natural gas delivered by a person who is not a local distribution company to a sales or transportation customer is payable by that person.

The tax on piped natural gas received by a person by means of a direct access to an interstate gas pipeline for consumption by that person is payable by that person.

## **3. Due Date of the Report and Tax**

The returns are required quarterly and are due by the last day of the month following the end of the calendar quarter. The quarterly return will include, (a) the piped natural gas delivered during the quarter to sales or transportation customers in each city in the State and, (b) the piped natural gas received during the month in each city in the State by persons who have direct access to an interstate gas pipeline and who receive the gas for their own consumption.

The piped natural gas tax is payable monthly, on the 20<sup>th</sup> day of the month following the calendar month in which the tax liability for the tax accrues. In addition, if a taxpayer's piped natural gas tax liability is consistently at least ten thousand dollars (\$10,000) per month, the taxpayer must prepay the next month's tax liability at the same time that it is paying the current month's liability. The prepayment must equal at least sixty-five percent (65%) of any of the following:

- The amount of tax due for the current month.
- The amount of tax due for the same month in the preceding year.
- The average monthly amount of tax due in the preceding calendar year.

A taxpayer that is required to prepay its tax is required to pay its piped natural gas excise tax by electronic means.

**4. Form Used for Filing**

Form CD-312 is to be used by piped natural gas companies.

**5. Distribution to Municipalities**

The amount to be distributed to each city will be one-half of the amount of tax attributable to that city for the quarter. Distribution to the cities will be within seventy-five (75) days after the end of each calendar quarter.

**6. Credit Against General Business Franchise Tax Imposed by G.S. 105-122 (G.S. 105-122(d1))**

A corporation subject to the excise tax on piped natural gas is also subject to the general business franchise tax. In computing the franchise tax, the corporation is allowed a credit of one-half of the piped natural gas excise tax paid during the taxable year as a credit against the general business franchise tax. The credit is limited to the amount of franchise tax.

## **VI. PRIVILEGE TAXES** **(Article 2)**

### **A. General Information**

#### **1. Scope and Nature (G.S. 105-33)**

State privilege license taxes are imposed for the privilege of carrying on the business, exercising the privilege or doing the act named in Article 2 of the Revenue Laws of North Carolina. These taxes are in addition to any regulatory or qualification requirements to engage in the practice of a profession, business or trade.

#### **2. License Required (G.S. 105-103, G.S. 105-109)**

Before a person may engage in a business, trade or profession for which a license is required under this Article, the person must be licensed by the Department. A license must be displayed conspicuously at the location of the licensed business, trade, or profession. A required license should be applied for (Form B-202A) before beginning business. Licenses issued under G.S. 105-41 are personal privilege licenses and must be issued in the name of the individual with the individual's social security number.

#### **3. Tax Year (G.S. 105-33)**

The privilege license tax is an annual tax and is due by July 1 of each year. The license tax is not prorated, instead, the full amount of the license tax is due when a person begins to engage in an activity for which a license is required at any time during the fiscal year, July 1 – June 30. Licenses are renewable annually (Form B-202A) by July 1 and no grace period is allowed before penalty accrues.

#### **4. Engaged in More than One Business (G.S. 105-105)**

Where any person, firm, or corporation is engaged in more than one business, trade, employment, or profession that is subject to State license taxes under the provisions of this Article, such persons, firms, or corporations must pay the license tax prescribed in this Article for each separate business, trade, employment, or profession.

#### **5. Penalty (G.S. 105-103, G.S. 105-109, G.S. 105-236)**

It is unlawful to engage in business without obtaining a required privilege license. The penalty for failure to obtain a license is the greater of five dollars (\$5) or five percent (5%) of the tax due for each thirty (30) days or fraction thereof from the time the tax is due until the tax is paid, up to a maximum not to exceed twenty-five percent (25%). The penalty for failure to pay the tax when due is the greater of five dollars (\$5) or ten percent (10%) of the tax due.

The Secretary may collect a tax due under this Article in any manner allowed under Article 9 of Chapter 105. The penalty and provisions of this section for the collection of delinquent license taxes apply to taxes levied by counties, cities, and towns of the State under the authority of this Article, or any other provision of law, in the same manner and to the same extent as they apply to taxes levied by the State.

**6. Effect of Change in Name of Firm (G.S. 105-106)**

A firm, partnership, or corporation, will be regarded as continuing when the name of the firm, partnership, or corporation is changed, a new partner is taken in, or one or more partners withdraw from the firm, if any one or more of the partners remain, or if there is change in ownership of less than a majority of the stock.

**7. Liability upon Transfer of Business (G.S. 105-33(h))**

A grantee, transferee, or purchaser of any business or property subject to the privilege taxes imposed in this Article must make diligent inquiry as to whether the State tax has been paid. If the business or property has been granted, sold, transferred, or conveyed to an innocent purchaser for value and without notice that the vendor owed or is liable for any of the State taxes imposed under this Article, the property, while in the possession of the innocent purchaser, is not subject to any lien for the taxes.

**8. Property used in a Licensed Business not Exempt from Taxation (G.S. 105-108)**

A State license, issued under any of the provisions of this Article will not be construed to exempt the property employed in such licensed business, employment, or profession from other forms of taxation.

**B. Dances, Athletic Events, Shows, Exhibitions, and Other Entertainment (G.S. 105-37.1)**

**1. Scope**

A privilege tax is imposed on the gross receipts of a person who is engaged in any of the following:

- Giving, offering, or managing a dance or an athletic contest for which an admission fee in excess of fifty cents (50¢) is charged.
- Giving, offering, or managing a form of amusement or entertainment that is not taxed by another provision of Article 2 of Chapter 105 of the General Statutes and for which an admission is charged.
- Exhibiting a performance, show, or exhibition, such as a circus or dog show that is not taxed by another provision of Article 2 of Chapter 105 of the General Statutes.

**2. Rate and Payment of Tax**

**a. Computation**

The privilege tax rate is three percent (3%) of the gross receipts from the activities described above and is computed on the admission price of the amusements, less any federal tax included in the admission price.

Gross receipts taxes are not deducted from the admission price to determine the tax base. (17 NCAC 04B.0302)

A fee charged by a person, firm or corporation engaged in a business taxed under G.S. 105-37.1 for a “membership card” entitling the holder to admission to an

amusement is an admission charge subject to the three percent (3%) gross receipts tax. (17 NCAC 04B.0303)

A night club making a charge for both food and entertainment, with sales tax added covering only part of this charge for food, is subject to the three percent (3%) gross receipts tax on the remainder of the charge, and a separate gross receipts report must be filed. (17 NCAC 04B.0304)

The exemption in G. S. 105-40 for the first one thousand dollars (\$1,000) of receipts derived by a civic organization from a dance or another amusement promoted and managed by the organization applies separately to each dance or other amusement. (17 NCAC 04B.0306)

A drag strip operation or a go-cart race for which an admission is charged to the spectators is subject to the gross receipts tax imposed under G.S. 105-37.1. If a person operates a drag strip or a go-cart track where spectator fees are not charged, but a fee is charged to individuals for the use of the strip or track for their own entertainment, the fees are not subject to the gross receipts tax. (17 NCAC 04B.0308)

An admission charge to a fishing pier is subject to the gross receipts tax imposed under G.S. 105-37.1 if the charge is for being a spectator on a pier. (17 NCAC 04B.0310)

An admission charge to a horse or dog show is subject to the gross receipts tax imposed under G.S. 105-37.1. (17 NCAC 04B.0311)

A rattlesnake milking exhibition for which an admission fee is charged is subject to the gross receipts tax imposed under G.S. 105-37.1. (17 NCAC 04B.0312)

**b. Payment**

The gross receipts taxes imposed on amusements must be reported on Form B-205. The tax is due when a return is due. A return is due by the 10<sup>th</sup> day after the end of each month and covers the gross receipts received during the previous month.

**3. Advance Report**

A person who owns or controls a performance, show or exhibition subject to the tax imposed by this section and who plans to bring the performance to this State from outside the State must file a statement with the Secretary that lists the dates, times, and places of the performance, show or exhibition. The statement must be filed no less than five days before the first performance, show, or exhibition in this State.

**C. Motion Picture Shows (G.S. 105-38.1)**

**1. Scope**

A privilege tax is imposed on the gross receipts of a person who is engaged in the business of operating a motion picture show for which an admission is charged.

**2. Rate and Payment of Tax**

The privilege tax is one percent (1%) of the gross receipts from admissions. The tax is due when a return is due. A return is due by the 10<sup>th</sup> day after the end of each month and covers gross receipts received during the previous month.

**3. Alternate Basis of Tax**

If a person offers an entertainment or amusement that includes both a motion picture taxable under G.S. 105-38.1 and an entertainment or amusement taxable under G.S. 105-37.1, the tax in that statute applies to the entire gross receipts and the tax levied in this section does not apply.

**D. Amusements – Certain Exhibitions, Performances, and Entertainment Exempt (G.S. 105-40)**

The following forms of amusements are exempt from the taxes imposed under Article 2 of Chapter 105 of the General Statutes:

1. All exhibitions, performances, and entertainments, except those expressly mentioned in Article 2 as not exempt, produced by local talent exclusively, for the benefit of religious, charitable, benevolent or educational purposes, as long as no compensation is paid to the local talent.
2. The North Carolina Symphony Society, Incorporated, as specified in G.S. 140-10.1.
3. All exhibits, shows, attractions, and amusements operated by a society or association organized under the provisions of Chapter 106 of the General Statutes where the society or association has obtained a permit from the Secretary to operate without the payment of taxes under Article 2.
4. All outdoor historical dramas, as specified in Article 19C of Chapter 143 of the General Statutes.
5. All elementary and secondary school athletic contests, dances, and other amusements.
6. The first one thousand dollars (\$1,000) of gross receipts derived from dances and other amusements actually promoted and managed by civic organizations when the entire proceeds of the dances or other amusements are used exclusively for civic and charitable purposes of the organizations and not to defray the expenses of the organization conducting the dance or amusement. The exemption applies separately to each dance or other amusement (17 NCAC 04B.0306). The mere sponsorship of a dance or another amusement by a civic or fraternal organization does not exempt the dance or other amusement, because the exemption applies only when the dance or amusement is actually managed and conducted by the civic or fraternal organization.

7. A youth athletic contest with an admissions price that does not exceed ten dollars (\$10.00) sponsored by a person exempt from income tax under Article 4 of this Chapter. For the purpose of this subdivision, a youth athletic contest means a contest in which each participating athlete is less than twenty (20) years of age.
8. All dances, motion picture shows, and other amusements promoted and managed by a qualifying corporation that operates a center for the performing and visual arts if the dance or other amusement is held at the center. "Qualifying corporation" means a corporation that is exempt from income tax under G.S. 105-130.11(a)(3). "Center for the performing and visual arts" means a facility, having a fixed location, that provides space for dramatic performances, studios, classrooms, and similar accommodations to organized arts groups and individual artists. This exemption does not apply to athletic events.
9. All exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from income tax under G.S. 105-130.11(a)(3) and is primarily organized to offer choral and theatrical performances. This exemption does not apply to athletic events.
10. A person that is exempt from income tax under Article 4 of Chapter 105 and is engaged in the business of operating a teen center. A "teen center" is a fixed facility whose primary purpose is to provide recreational activities, dramatic performances, dances, and other amusements exclusively for teenagers.
11. All entertainment or amusements offered or given on the Cherokee Indian reservation when the person giving, offering, or managing the entertainment or amusement is authorized to do business on the reservation and pays the tribal gross receipts levy to the tribal council.
12. Arts festivals held by a person that is exempt from income tax under Article 4 of Chapter 105 and that meets the following conditions:
  - The person holds no more than two arts festivals during a calendar year.
  - Each of the person's arts festivals last no more than seven consecutive days.
  - The arts festivals are held outdoors on public property and involve a variety of exhibitions, entertainments, and activities.
13. Community festivals held by a person who is exempt from income tax under Article 4 of Chapter 105 and that meets all of the following conditions:
  - The person holds no more than one community festival during a calendar year.
  - The community festival lasts no more than seven consecutive days.
  - The community festival involves a variety of exhibitions, entertainments, and activities, the majority of which are held outdoors and are open to the public.

14. All farm-related exhibitions, shows, attractions, or amusements offered on land used for bona fide farm purposes as defined in G.S. 153A-340. Bona fide farm purposes include the production and activities relating or incidental to the production of crops, fruits, vegetables, ornamental and flowering plants, dairy, livestock, poultry, and all other forms of agricultural products having a domestic or foreign market. The production of a nonfarm product that the Department of Agriculture and Consumer Services recognizes as a “Goodness Grows in North Carolina” product that is produced on a farm subject to a conservation agreement under G.S. 106-743.2 is a bona fide farm purpose.”

**E. Attorneys-at-Law and Other Professionals (G.S. 105-41)**

Every individual in this State who practices a profession or engages in a business and is included in the following list must obtain a statewide license for the privilege of practicing the profession or engaging in the business from the Secretary. A license required by this section is not transferable to another person. The tax for each license is fifty dollars (\$50.00).

**1. Professions and/or Businesses Requiring a Privilege License:**

- a. An attorney-at-law.
- b. A physician, a veterinarian, a surgeon, an osteopath, a chiropractor, a chiropodist, a dentist, an ophthalmologist, an optician, an optometrist, or another person who practices a professional art of healing.

G.S. 90-236 states that “fitting glasses on the face” constitutes practicing as a dispensing optician. Therefore, dispensing opticians fitting frames to customers’ faces, and making adjustments thereto, are subject to optician’s privilege license tax. (17 NCAC 04B.0609)

A physical therapist who independently applies physical therapy for a reward is practicing the art of healing and is therefore subject to privilege license. (17 NCAC 04B.0610)

A psychologist who engages in the art of healing for a fee or reward is subject to privilege license. The psychologist license is not levied on the practice of psychology, as such, but on persons engaged in the art of healing which does include psychologists if they engage in such activity. (17 NCAC 04B.0614)

In addition to the regulatory license issued by the State Board of Medical Examiners, a practicing physician shall apply for and obtain from the Secretary of Revenue a statewide physician privilege license. Varying situations involving a physician and the applicability of the physician privilege license tax for these situations are as follows:

- A physician in private practice, either exclusively or partially, is subject to the physician privilege license tax;
  - A physician practicing his profession and compensated in part from a fund or “pool” derived in part or in full from fees charged for his services is subject to the physician privilege license tax notwithstanding the fact that some of his compensation may also come from appropriations, grants, business income (income from a “business” in the non-professional sense; for example, a physician employed by an industrial plant to attend its industrial employees at its plant), or other “non-fee” sources.
- c. A professional engineer, as defined in G.S. 89C-3.
  - d. A registered land surveyor, as defined in G.S. 89C-3.
  - e. An architect, including any architect employed by another architect, who renders architectural services.
  - f. A landscape architect, including any architect employed by another architect, who renders architectural services.
  - g. A photographer, a canvasser for any photographer, or an agent of a photographer in transmitting photographs to be copied, enlarged, or colored. A licensed photographer having a located place of business in this State is liable for the license tax on each agent or solicitor employed by the photographer for soliciting business.
  - h. A real estate broker or a real estate salesman, as defined in G.S. 93A-2. A real estate broker or a real estate salesman who is also a real estate appraiser is required to obtain only one license under this section to cover both activities.
  - i. A real estate appraiser, as defined in G.S. 93E-1-4. A real estate appraiser who is also a real estate broker or a real estate salesman is required to obtain only one license under this section to cover both activities.
  - j. A person who solicits or negotiates loans on real estate as agent for another for a commission, brokerage, or other compensation.
  - k. A mortician or embalmer licensed under G.S. 90-210.25.
  - l. Public practice of accounting:

Every person engaged in the public practice of accounting as a principal, or as a manager of the business of public accountant, shall pay for such license fifty dollars (\$50.00), and in addition, shall pay a license tax of twelve dollars and fifty cents (\$12.50) for each person employed who is engaged in the capacity of supervising or handling the work of auditing, devising or installing systems of accounts.

A bookkeeper who acts as an independent contractor preparing tax returns for small business firms, as well as individuals, and charges for his services, is subject to accountant's privilege license, as such work requires training and skill in accounting. Also, an independent contractor who prepares income tax returns, other than the simplified individual returns, and charges for such work, is subject to accountant's privilege license. (17 NCAC 04B.0603)

G.S. 105-41 is purely a revenue measure and does not purport to be a regulatory measure. Certified public accountants have written into their statute a provision limiting the issuance of CPA privilege licenses to applicants who are duly licensed by their regulatory body, but this is not true with respect to other professions covered by G.S. 105-41, nor to accountants who are not certified public accountants as defined in said regulatory laws. (17 NCAC 04B.0603)

## **2. Persons Exempt from the Tax**

The following persons are exempt from the tax:

- a. A person who is at least seventy-five (75) years old.
- b. A person practicing the professional art of healing for a fee or reward, if the person is an adherent of an established church or religious organization and confines the healing practice to prayer or spiritual means.
- c. A blind person engaging in a trade or profession as a sole proprietor. A "blind person" means any person who is totally blind or whose central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or field subtends an angle no greater than twenty (20) degrees. This exemption does not extend to any sole proprietor who permits more than one person other than the proprietor to work regularly in connection with the trade or profession for remuneration or recompense of any kind, unless the other person in excess of one so remunerated is a blind person.
- d. A physician employed exclusively by the federal, state or local government(s) and not holding himself/herself out to the public and does not share in the fees paid. (17 NCAC 04B.0612)
- e. A physician practicing his/her profession but wholly compensated from appropriations, grants, business income (income from a "business" in the non-professional sense; for example, a physician employed by an industrial plant to attend its industrial employees at its plant), or from sources other than funds generated by fees charged for his/her services. (17 NCAC 04B.0611)
- f. A physician licensed by the State Board of Medical Examiners but not performing duties appropriate to his/her profession; for example, is the head of a State agency and has no medical practice). (17 NCAC 04B.0611)

- g. A physical therapist who works only under the orders and direction of registered physicians and does not attempt to diagnose and independently apply physical therapy. (17 NCAC 04B.0610)
- h. A masseur or masseuse. (17 NCAC 04B.0608)
- i. A person employed by an architect as a draftsman only, and fees paid for his services are not for architectural services rendered. (17 NCAC 04B.0605)
- j. A person who sells grave plots only, even though a deed is given. (17 NCAC 04B.0606)
- k. A land surveyor employed by a civil engineer who does not both survey the area and draw the description. (17 NCAC 04B.0607)

### **3. Licenses**

Licenses issued under this section are issued as personal privilege licenses and will not be issued in the name of a firm or corporation. If any person engages in more than one of the activities for which a privilege tax is levied by this section, the person is liable for a privilege tax with respect to each activity engaged in.

Counties and cities may not levy any license tax on the business or professions taxed under this section.

Obtaining a license required by this Article does not of itself authorize the practice of a profession, business, or trade for which a State qualification license is required.

## **F. Installment Paper Dealers (G.S. 105-83)**

### **1. Basis for Taxation**

Every person engaged in the business of dealing in, buying, or discounting installment paper, notes, bonds, contracts, or evidences of debt, where at the time of or in connection with the execution of said instruments, a lien is reserved or taken upon personal property located in this State to secure the payment of such obligations, is subject to the installment paper dealers tax. The primary factors in determining liability are: (a) three party transactions, (b) obligations concerning personal property and (c) liens reserved upon personal property in this State to secure payment of such obligations.

Example: A motor vehicle dealer sells an automobile (personal property) and accepts a retail installment contract from the customer. A lien is reserved on the title of the vehicle. The dealer sells or assigns the retail installment contract to a third party. The purchaser of the retail installment contract from the dealer is liable for the installment paper dealers' tax.

**2. Additional Tax and Reports (17 NCAC 04B. 2903, 17 NCAC 04B .2904)**

Form B-203, Installment Paper Dealer Quarterly Report, is used to remit the tax at the rate of .277 percent of the total face value of paper subject to the tax. Face value is normally the amount financed, excluding finance charges. The quarterly report, with remittance, is due no later than the twentieth day of January, April, July and October of each year.

**3. Nonresident Engaged in Business (17 NCAC 04B .2905)**

This tax is not imposed on the business of dealing in, buying and/or discounting installment paper which is engaged in exclusively in a foreign state. When any of the activity incident to such business occurs in North Carolina, the tax applies. Such activities include the promotion and solicitation of such business by employees or agents within this State, whether or not the transfer of such paper is consummated in this State.

**4. Liability for Direct Loans (17 NCAC 04B .2902)**

A person who is engaged in the business of making direct loans (two party transactions) and also purchases installment paper (three party transactions) is subject to both the tax on installment paper dealers (G.S. 105-83) and the tax on loan agencies (G.S. 105-88).

**G. Loan Agencies or Brokers, including Pawnbrokers and Check Cashers (G.S. 105-88)**

**1. Privilege Tax**

An annual privilege tax of two hundred and fifty dollars (\$250.00) is levied on every person, firm, or corporation engaged in any of the following businesses for each location at which the business is conducted:

- The business of making loans or lending money, accepting liens on, or contracts of assignments of, salaries or wages, or any part thereof, or other security or evidence of debt for repayment of such loans in installment payment or otherwise.
- The business of check cashing regulated under Article 22 of Chapter 53 of the General Statutes.
- The business of pawnbroker regulated under Chapter 91A of the General Statutes.

**2. Real Estate Loans – Loaning Own Funds**

A person who, as agent, engages in the business of negotiating real estate loans using funds belonging to his loan correspondents is subject to real estate license under G.S. 105-41. A person making real estate loans in his own name with his own funds and selling those loans to insurance companies and other loan investment companies is subject to loan agency license under G.S. 105-88 unless meeting the exemption described below. A person engaging in both activities is subject to both licenses. (17 NCAC 04B.3301)

### **3. Real Estate Loans – Personal Property Collateral**

A person who negotiates real estate loans for others and also includes as part of the collateral mortgages on automobiles or other personal property is subject to loan agency license under G.S. 105-88 and real estate license under G.S. 105-41. (17 NCAC 04B.3302)

### **4. Loan Statement Required**

At the time of making any such loan, the person, or officer of the firm or corporation making the loan, must give to the borrower in writing in convenient form a statement showing the amount received by the borrower, the amount to be paid back by the borrower, the time in which the amount is to be paid, and the rate of interest and discount agreed upon.

### **5. Exempt Entities**

G.S. 105-88 does not apply to banks, industrial banks, trust companies, savings and loan associations, cooperative credit unions, the business of negotiating loans on real estate as described in G.S. 105-41, or insurance premium finance companies licensed under Article 35 of Chapter 58 of the General Statutes.

### **6. Noncompliance with G.S. 105-88**

A loan made by a person who does not comply with G.S. 105-88 is not collectible at law under G.S. 105-269.13.

## **H. Banks (G.S. 105-102.3)**

### **1. Scope**

An annual privilege tax is imposed upon every bank or banking association, including each national banking association, that is operating in this State as a commercial bank, an industrial bank, a savings bank created other than under Chapter 54B or 54C of the General Statutes or the Home Owners' Loan Act of 1933 (12 U.S.C. §§ 1461-68), a trust company, or any combination of such facilities or services. The annual privilege tax applies whether such bank or banking association, hereinafter referred to as a bank or banks, is organized, under the laws of the United States or the laws of North Carolina, in the corporate form or in some other form of business organization.

### **2. Report, Tax Basis, and Tax Rate**

A report and the privilege tax are due by the first day of July of each year on forms provided by the Secretary. The tax rate is thirty dollars (\$30.00) for each one million dollars (\$1,000,000) or fractional part thereof of total assets held as provided. The assets upon which the tax is levied is determined by averaging the total assets shown in the four quarterly call reports of condition (consolidating domestic subsidiaries) for the preceding calendar year as required by bank regulatory authorities. If a bank has been in operation less than a calendar year, then the assets upon which the tax is levied is determined by multiplying the average of the total assets by a fraction, the denominator of which is 365 and the numerator of which is the number of days of operation.

### **3. International Banking Facility**

If a bank operates an international banking facility, as defined in G.S. 105-130.5(b)(13), the assets upon which the tax is levied will be reduced by the average amount for the taxable year of all assets of the international banking facility which are employed outside the United States, as computed pursuant to G.S. 105-130.5(b)(13)c.

### **4. Multistate Operations**

For an out-of-state bank with one or more branches in this State, or for an in-state bank with one or more branches outside this State, the assets of the out-of-state bank or of the in-state bank upon which the tax is levied will be reduced by the average amount for the taxable year of all assets of the out-of-state bank or of the in-state bank which are employed outside this State. The tax imposed in this section will be for the privilege of carrying on the businesses herein defined on a statewide basis regardless of the number of places or locations of business within the State.

## **I. Publishers of Newsprint Publications (G.S. 105-102.6)**

### **1. Scope**

Publishers of newsprint publications are encouraged to use newsprint that contains recycled content. Any publisher as defined in G.S. 105-102.6(a)(4) who does not meet the State's minimum recycled content percentage is subject to a privilege tax on the tonnage consumed that is below the required minimum.

### **2. Minimum Recycled Content Percentage**

The State's minimum recycled content percentage of newsprint consumed by a publisher is forty percent (40%).

### **3. Recycling Program Partial Credit**

A publisher who has developed and operated or contracts for the operation of a newspaper or magazine recycling program will receive partial credit toward the recycled content percentage requirements on the basis of one ton of credit toward its taxable total recycled content tonnage for each ton of recycling tonnage.

### **4. Tax Reporting Number, Tax Report, and Tax**

Every publisher must apply for and obtain from the Secretary a newsprint publisher tax reporting number. The State assigns a tax reporting number identical to the publisher's federal employer identification number for State reporting purposes.

Every publisher must file an annual report on Form B-302 with the Secretary by January 31 of each year. The report must include all the information required by statute for the preceding calendar year.

In addition, each publisher whose recycled content percentage for a calendar year is less than the applicable minimum recycled content percentage must pay a tax of fifteen dollars (\$15.00) on each ton by which the required minimum recycled content tonnage exceeds the publisher's recycled content tonnage consumed. This tax is due when the report is filed.

## **5. Exemption**

Each publisher is allowed an exemption of otherwise taxable tonnage to the extent the amount being exempted is attributable solely to the publisher's inability to obtain sufficient recycled content newsprint because

- Recycled content newsprint was not available at a price comparable to the price of virgin newsprint;
- Recycled content newsprint of a quality comparable to virgin newsprint was not available; or
- Recycled content newsprint was not available within a reasonable period of time during the reporting period.

Each publisher claiming the exemption must provide all the information required by statute to the Secretary.

## **VII. INSURANCE PREMIUM TAX (Article 8B)**

### **A. General Information (G.S. 105-228.5, 105-228.8)**

North Carolina levies several types of insurance premium tax upon insurers, both domestic and foreign, for the privilege of engaging in insurance business. Foreign insurers are subject to retaliatory provisions.

### **B. Insurance Companies Subject to the Tax (G.S. 105-228.5, G.S. 58-6-25)**

All insurers as defined in G.S. 58-1-5, all hospital, medical, and dental service insurers organized as Article 65 corporations under G.S. 58-65, and all self-insurers organized and licensed in accordance with G.S. 58-47, G.S. 97-5 or G.S. 97-93, including groups of employers who have pooled their liabilities and employers that carry their own risks, are subject to gross premium tax pursuant to G.S. 105-228.5 and the retaliatory tax provisions set forth in G.S. 105-228.8.

All insurers, all hospital, medical and dental service insurers organized as Article 65 corporations, all self-insurers, and all health maintenance organizations are subject to the insurance regulatory charge pursuant to G. S. 58-6-25.

### **C. Types of Tax and Charges (G.S. 105-228.5, G.S. 58-84-1, G.S. 58-6-25)**

There are several types of insurance premium tax applied, according to the type of insurance company and the type of insurance written. Gross and Retaliatory Premium Tax, Additional Statewide Fire and Lightning Tax, and Additional Local Fire and Lightning Tax are types of insurance premium tax reported. Tax rates, according to the type of insurance written, apply to each type of tax. Printed returns are generated from a computer program provided by the NC Department of Revenue. Printed returns and the completed diskette provided by the Department must be submitted. Other sources of the computer program, if used, must obtain prior approval.

Insurers, Article 65 corporations, health maintenance organizations, and self-insurers are required to pay an Insurance Regulatory Charge in addition to all other fees and taxes. For insurers and self-insurers, the Insurance Regulatory Charge is a percentage of the gross premium tax liability, exclusive of any additional taxes imposed by G.S. 105-228.8, any credits allowed under G.S. 105-228.5A or G.S. 97-133(a), and any other credits allowed under Chapter 105 of the General Statutes, for the taxable year. For health maintenance organizations, the Insurance Regulatory Charge is a percentage of a presumed tax liability for the year calculated as if the corporation or organization were an insurer providing health insurance. The same exclusions apply for Article 65 corporations and health maintenance organizations that apply for insurers and self-insurers.

### **D. Tax Basis (G.S. 105-228.5)**

The tax imposed on an insurer is based on gross premiums from business done in the State during the calendar year. Finance charges are included in gross premiums.

In the case of life insurance contracts, including supplemental contracts providing for disability benefits, accidental death benefits, or other special benefits that are not annuities and excluding contracts of reinsurance, gross premiums from business done means all premiums collected in the calendar year. Insurers are allowed to deduct premiums refunded on policies rescinded for fraud or other breach of contract and premiums that were paid in advance on life insurance contracts and subsequently refunded to the insured, premium payer, beneficiary, or estate.

For all other contracts of insurance, including contracts of insurance required to be carried by the Workers' Compensation Act and excluding contracts of reinsurance, gross premiums from business done in the State means all premiums written, or the equivalent thereof in the case of self-insurers under the Workers' Compensation Act, for contracts covering property or risks in this State, whether the premiums are designated as premiums, deposits, premium deposits, policy fees, membership fees, or assessments.

If, for any tax year, returned premiums exceed gross premiums collected, insurers may reduce taxable premiums to zero. The general statutes do not provide for the carryforward of any unused returned premiums or the refund of premium taxes on any unused return premiums.

When insurers are ordered by the Department of Insurance to establish escrow accounts of possible premium overcharges, reductions in gross premiums are allowed after any refunds have been paid to insureds, not when the escrows are established.

An insurer may exclude the following in determining gross premiums from business done in this State:

- Premiums properly reported and properly allocated as being received from business done in some other nation, territory, state, or states.
- Premiums received from policies written in federal areas for persons in military service who pay premiums by assignment of service pay.
- Premiums received from policies or contracts issued in connection with the funding of a pension, annuity, or profit-sharing plan qualified or exempt under section 401, 403, 404, 408, 457, or 501 of the Internal Revenue Code as defined in G.S. 105-228.90.
- Premiums or considerations received from annuities, as defined in G.S. 58-7-15.
- Funds or considerations received in connection with funding agreements, as defined in G.S. 58-7-16.
- Medicaid or Medicare premiums, to the extent federal law prohibits their taxation.

**E. Tax Rates and Charges (G.S. 105-228.5, G.S. 58-6-25)**

Tax rates and charges are as follows:

Workers' Compensation	2.50%
Other taxable contracts	1.90%
Additional Statewide Fire and Lightning (excluding auto and marine)	1.33%
Additional Local Fire and Lightning	.50%
Article 65 Corporations	1.90%
Health Maintenance Organizations (2007)	1.90%
Insurance Regulatory Charge (2007)	5.50%*

\*Subject to change each year and is established by the General Assembly based on a proposed percentage rate submitted by the NC Department of Insurance sufficient to defray the estimated cost of the operations of the NC Department of Insurance for each upcoming fiscal year.

Effective for taxable years beginning on or after January 1, 2008, the additional statewide and local fire and lightning taxes are repealed and replaced with an additional tax on property coverage contracts. This additional tax on property coverage is imposed on ten percent (10%) of the gross premiums from policies providing coverage for automobile physical damage and all other property coverage contracts including policies providing coverage for wind damage. See G.S. 105-228.5(d)(3) for definitions. The tax rate is seventy-four hundredths percent (0.74%).

**F. Retaliatory Provisions (G.S. 105-228.8)**

When the laws of any other state impose, or would impose, any premium taxes, upon North Carolina companies doing business in the other state that are, on an aggregate basis, in excess of the premium taxes directly imposed upon similar companies by the statutes of this State, the Secretary of Revenue shall impose the same premium taxes, on an aggregate basis, upon the companies chartered in the other state doing business or seeking to do business in North Carolina. Retaliatory tax is reported and paid with the annual Gross Premium Tax return. Special purpose obligations or assessments based on premiums imposed in connection with particular kinds of insurance, the special purpose regulatory charge and dedicated special purpose taxes based on premiums are excluded from retaliatory computations. Seventy-five percent (75%) of the Additional Statewide Fire and Lightning tax is included in the retaliatory computations.

If an insurer changes its state of domicile during the calendar year, the retaliatory tax must be calculated taking into account the portion of the year the company was domiciled in each state, respectively. For example, Company B is chartered in State A from January 1 through July 31, but changes its state of domicile to State B, effective August 1. The retaliatory calculation should reflect the taxes and includable fees and assessments charged by State A for business done for the period January 1 through July 31 and the taxes and includable fees and assessments charged by State B for business done for the period August 1 through December 31. Appropriate documentation

supporting the retaliatory calculation must be attached to the gross premium tax return for the calendar year.

**G. Installment Payments (G.S. 105-228.5(f))**

Insurers, Article 65 corporations, health maintenance organizations, and self-insurers that have a premium tax liability, not including the additional local fire and lightning tax, of ten thousand dollars (\$10,000) or more for business done in North Carolina during the immediately preceding year must remit three equal installments with each installment equal to at least thirty-three and one-third percent (33 1/3%) of the premium tax liability incurred in the immediately preceding taxable year. The due dates are April 15, June 15, and October 15 of each year. For taxable year 2007, HMOs are required to make two installments with each installment equal to one-half of the estimated tax liability for 2007. The installments are due April 15 and June 15. For taxable year 2008 and later HMOs are required to make three installments having the same due dates as for other insurers.

Any insurer, corporation, self-insurer, or organization required to make premium tax installments, must also make installment payments of the Insurance Regulatory Charge. The same percentage and due date guidelines applicable to estimated installment payments of premium tax must be used in calculating and paying the insurance regulatory charge.

The balance of premium tax and insurance regulatory charge due is remitted by the following March 15 along with the annual tax return. The Secretary may permit an insurance company to pay less than the required installment amount when the insurer reasonably believes that the total estimated payments made for the current year will exceed the total anticipated tax liability for the year. An underpayment of an installment payment shall bear interest.

**H. Due Dates (G.S. 105-228.5(e))**

Annual returns along with payment of tax are due on or before March 15 of each year. Installment returns (if required) along with payment of tax are due on or before April 15, June 15, and October 15 of each year. For taxable year 2007, HMOs are required to make two installments with each installment equal to one-half of the estimated tax liability for 2007. The installments are due April 15 and June 15. For taxable year 2008 and later HMOs are required to make three installments having the same due dates as for other insurers.

**I. Electronic Funds Transfer (EFT) Requirement (G.S. 105-241, 105-236(lb))**

Insurance companies paying premium tax of two hundred forty thousand dollars (\$240,000) or more in a fiscal year are required to remit this tax by EFT beginning with payments made in the following calendar year. Insurance companies will be notified by the Department if required to make EFT payments. Payments received in the wrong form are subject to a penalty equal to five percent (5%) of the tax. For additional information on EFT, refer to the subject, "Payments of Tax by EFT" under "General Administration."

**J. Exempt Insurance Companies (G.S. 105-228.5(g))**

The insurance premium tax requirements do not apply to farmers' mutual assessment fire insurance companies, to fraternal orders or societies that do not operate for a profit and do not issue policies on any person except members.

**K. Tax Credits (G.S. 105-228.5A, G.S. 97-29.1, G.S. 105-129.16B, Article 3A, Article 3H, and Article 3J)**

**1. Guaranty Assessment Credits**

North Carolina Guaranty Association assessments paid by insurers may be used as a credit against premium tax. The credit is twenty percent (20%) per year for a period of five years beginning with the year after payment of the assessment. The credit applies to all Insurance Guaranty Association and Life and Accident and Health Insurance Guaranty Association assessments paid. The credit may not exceed the premium tax liability for the year. Self-Insured Guaranty Association assessments paid may be applied as a hundred percent (100%) credit for the year in which it is paid.

**2. Supplemental Workers' Compensation Credits**

Supplemental workers' compensation benefits paid to NC residents may be applied as a credit.

**3. Tax Credits for New and Expanding Businesses**

Tax credits provided under Article 3A are allowed to be taken against gross premiums tax. Article 3A expired, with certain exceptions, for taxable years beginning on or after January 1, 2007.

**4. Tax Credit for Low-income Housing**

Effective for taxable years beginning on or after January 1, 2001, for buildings placed in service on or after that date, the tax credit for low-income housing may be taken against gross premium tax. See "Credit for Low-income Housing" in the "Credits" section for further information about this credit.

**5. Tax Credit for Mill Rehabilitation**

The tax credit for mill rehabilitation may be taken against gross premium tax. See "Credit for Mill Rehabilitation" in the "Tax Credits" section for further information on this credit.

**6. Tax Credit for Growing Businesses**

The tax credits for growing businesses may be taken against gross premium tax. See "Tax Credits for Growing Businesses" in the "Tax Credits" section for further information on this credit.

**L. Insurance Tax Administered by Department of Insurance (G.S. 105-228.9)**

Surplus lines tax, tax on risk retention groups not chartered in the State, and tax on persons procuring insurance directly with an unlicensed insurer are still administered

by the NC Department of Insurance. Licensing and filing fees of insurers are also administered by the NC Department of Insurance along with the financial reporting requirements for insurers.

**M. No Additional Local Taxes (G.S. 105-228.10)**

No county, city, or town shall be allowed to impose any additional tax, license, or fee, other than ad valorem taxes, upon any insurance company or association paying the fees and taxes levied under the insurance premium tax statutes.

**N. Exemption From Franchise or Corporate Income Tax (G.S. 105-228.5(a))**

An insurer, Article 65 corporation, or health maintenance organization that is subject to the insurance premium tax is not required to file or pay franchise or corporate income tax.

**O. Penalties**

If an insurer fails to file any return by the date it is due, the Secretary must assess a penalty equal to five percent (5%) of the tax if the failure is for not more than one month, with an additional five percent (5%) for each additional month, or fraction thereof, during which the failure continues. The maximum penalty is twenty-five percent (25%) in the aggregate, or five dollars (\$5), whichever is greater.

If an insurer fails to pay any tax when due, without intent to evade the tax, the Secretary must assess a penalty equal to ten percent (10%) of the tax. The penalty cannot be less than five dollars (\$5).

If an insurer knowingly and willfully fails to comply with any of the provisions in the General Statutes or the Administrative Code, the Secretary must assess a penalty equal to ten percent (10%) of the deficiency that is a result of the insurer's negligence.

## **VIII. GENERAL ADMINISTRATION (Article 9)**

### **A. Statute of Limitations; Assessment Procedure; Appeals Process (G.S. 105-241.6 – G.S. 105-241.23)**

Substantial changes were made to the statutes governing the assessments, refunds and appeals processes. The revised processes were generally effective January 1, 2008. The information in this section addresses the revised processes. For information on the processes effective through December 31, 2007, please see the Rules and Bulletins publication for 2005 – 2006 and the 2006 Supplement to the Rules and Bulletins.

#### **1. Statute of Limitations for Refunds (G.S. 105-241.6)**

The statute of limitations for filing a claim for refund of overpayment of taxes is three years from the statutory due date of the applicable return or two years from the date of overpayment whichever is later. These exceptions apply:

- If a taxpayer files a timely return reflecting a federal determination, the period for requesting a refund is the later of 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.
- 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. If a taxpayer's right to receive a refund had expired under the prior six-month statute of limitations, the new two-year statute of limitations does not reopen the taxpayer right to a refund.

#### **2. Procedure for Obtaining a Refund (G.S. 105-241.7)**

The Department must refund an overpayment it discovers if the statute of limitations has not expired. A taxpayer may request a refund of an overpayment by filing within the statute of limitations an amended return reflecting the overpayment or filing a claim for refund (form NC-19) that identifies the taxpayer, the type and amount of tax overpaid, the applicable tax period, and the basis for the claim. Identifying the basis for the claim does not limit the taxpayer from changing the basis.

Within six months of receiving the amended return or demand for return the Department must either

- refund the amount requested
- adjust the amount requested, refund the adjusted amount, and provide the taxpayer with a reason for the adjustment. If the refund is less than requested, the adjusted refund is considered a notice of denial for the amount of the requested refund that was not refunded.
- deny the refund in its entirety and send the taxpayer a notice of proposed denial, or
- request additional information concerning the request for refund. If a taxpayer fails to respond to a request for information, the Department must take one of

the actions listed above within the later of 1) the remainder of the six-month period; 2) thirty (30) days after receiving the information; 3) a time period mutually agreed upon by the Department and the taxpayer.

If the Department fails to take one of these actions within the required time, the inaction is considered to be a proposed denial of the requested refund. A notice of proposed denial must contain the basis for the proposed denial and the circumstance under which the proposed denial will become final. A proposed denial of a refund by the Secretary is presumed to be correct. A refund does not absolve a taxpayer of a tax liability that may in fact exist. The Secretary may propose an assessment for any deficiency as provided by law.

The Department cannot issue a refund of 1) an amount paid before the final return for the tax year is filed, 2) an overpayment setoff under Chapter 105A or under another setoff debt collection program authorized by law, 3) an income tax overpayment the taxpayer has elected to apply to another purpose as provided by law, or 4) an overpayment of less than three dollars (\$3.00) unless the taxpayer files a written claim for the refund.

### **3. Statute of Limitations for Assessments (G.S. 105-241.8)**

If a return is filed and no fraud is involved, the statute of limitations for an assessment is three years from the date the return was filed or the date the return was due to have been filed, whichever is later.

Any tax or additional tax due from the taxpayer may be assessed at any time if 1) no proper application for a license or no return has been filed, 2) a false or fraudulent application or return has been filed, or 3) there has been an attempt in any manner to fraudulently defeat or evade tax.

If a taxpayer files a return reflecting a federal determination and the return is filed within the statutory time for filing the return, the period for proposing an assessment of any tax due is the later of one year after the return is filed or three years after the original return was filed or due to be filed.

If there is a federal determination and the taxpayer fails to file the return within the required time, the period for proposing an assessment of any tax due is three years after the date the Secretary received the final report of the federal determination.

If a taxpayer forfeits a tax credit or tax benefit pursuant to forfeiture provisions in Chapter 105 the period for proposing an assessment of any tax due resulting from the forfeiture is three years after the date of the forfeiture.

If a taxpayer elects under section 1033(a)(2)(A) of the Code not to recognize gain from involuntary conversion of property into money, the period for proposing an assessment of any tax due as a result of the conversion or election is the applicable period provided under section 1033(a)(2)(C) or section 1033(a)(2)(D) of the Code.

**4. Procedure for Proposing an Assessment (G.S. 105-241.9)**

The Secretary and his agents have the power to examine the books, records, and other relevant data to determine the taxes owed by a corporation. Where it is impossible to obtain accurate and reliable information, an assessment may be made from the best information available and is considered to be correct.

The Secretary must propose an assessment within the statute of limitations for proposed assessments unless the taxpayer waives the limitations period in writing. A taxpayer may waive the limitations period for either a definite or an indefinite time. If the taxpayer waives the limitations period, the Secretary may propose an assessment at any time within the time extended by the waiver.

The Department must give a taxpayer a written notice of a proposed assessment. The notice must contain 1) the basis for the proposed assessment, 2) the amount of tax, interest, and penalties, stated separately, and 3) the circumstances under which the proposed assessment will become final and collectible. The statement of the basis does not limit the Department from changing the basis.

**5. Limit on Refunds and Assessments After a Federal Determination (G.S. 105-241.10) (effective for taxable years beginning on or after January 1, 2007)**

When a taxpayer files a timely 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. A federal determination is a correction or final determination by the federal government of the amount of a federal tax due.

**6. Requesting Review of Proposed Denial of Refund or Proposed Assessment (G.S. 105-241.11)**

Any taxpayer who objects to a proposed assessment or proposed denial of refund may request the Department to review the proposed action. The request for review must be filed within forty-five (45) days after 1) the date the notice of the proposed assessment or the proposed denial of refund was mailed to the taxpayer, if delivered by mail, 2) the date the notice of the proposed assessment or the proposed denial of refund was delivered to the taxpayer, if delivered in person; or 3) the date that inaction by the Department on a request for refund was considered a proposed denial of the refund. A request for review is considered filed on the date the request is delivered if delivered in person or on the date received by the Department if not delivered in person. A taxpayer requests a review by submitting form NC-242. An assessment for tax shown due on the return but not paid or the application of a refund against debt owed to State or local agency or to the Internal Revenue Service are not subject to review.

**7. Result When Taxpayer Does Not Request a Review (G.S. 105-241.12)**

A proposed denial of a refund becomes final and is not subject to further administrative review if the taxpayer does not file a timely request for Departmental review of the proposed denial. If the proposed denial becomes final, a taxpayer may not file another amended return or refund claim to obtain the denied refund.

A proposed assessment becomes final and is not subject to further administrative or judicial review if the taxpayer fails to file a timely request for Departmental review. After paying the tax, the taxpayer may request a refund of the tax paid. If a proposed assessment becomes final because the taxpayer does not file a timely request for review, the Department must send the taxpayer a notice of collection before it attempts to collect the tax. The notice must include a statement that the proposed assessment is final and collectible, the amount of tax, interest and penalties due, an explanation of the collection options available to the Department if the taxpayer does not pay the liability reflected on the notice and any remedies available to the taxpayer concerning these collection options.

**8. Action on Request for Review (G.S. 105-241.13)**

The Department, when it receives a timely request for a review of a proposed assessment or proposed denial of a refund, must conduct a review of the proposed action and either grant the refund or remove the assessment, schedule a conference with the taxpayer, or request additional information from the taxpayer concerning the requested refund or proposed assessment.

If the Department's review of a proposed assessment or proposed denial of a refund does not result in granting the refund requested or removing the assessment, the Department must schedule a conference which can be either face-to-face or by telephone. The Department must give the taxpayer 30 days notice of the time and place set for the conference unless the Department and the taxpayer agree to a conference in less than thirty (30) days. The purpose of the conference is for the parties to attempt to informally resolve the case. At the conference no testimony under oath will be taken, the rules of evidence do not apply and the taxpayer may present any objections to the proposed action. The taxpayer may designate a representative to act on the taxpayer's behalf at the conference.

**9. Final Determination after Department Review (G.S. 105-241.14)**

If the Department and the taxpayer are unable to resolve the taxpayer's objection to a proposed denial of refund, the Department must issue a notice of final determination that includes the basis for the final determination and the procedure for the taxpayer to follow for contesting the determination.

If the Department and the taxpayer are unable to resolve the taxpayer's objection to a proposed assessment, the Department must issue a notice of final determination that includes the amount of the tax, interest and penalties due, the procedure the taxpayer must follow to contest the final determination, a statement that the amount due stated on the notice is collectible if the taxpayer does not contest the final determination, and

an explanation of the collection options available to the Department if the taxpayer fails to pay the liability reflected on the notice and the remedies available to the taxpayer concerning these collection options. The basis for the determination may be stated on the notice or in a separate document and does not limit the Department from changing the basis.

The Department must conclude its review of the proposed assessment or proposed denial of a refund and issue a final determination within nine months of the date the taxpayer filed the request for review. The Department and the taxpayer may mutually agree to extend the time limit. If the Department fails to issue a final determination within nine months, the validity of the proposed assessment is not affected.

Timely protests of proposed assessments or denials of refunds filed before January 1, 2008 and pending as of that date will be considered requests for review under the new law without the taxpayer having to submit a new request. The Department has nine months from January 1, 2008 to conclude its review of the proposed assessment or proposed denial of a refund and issue a final determination if needed.

#### **10. Contested Case Hearing on Final Determination (G.S. 105-241.15)**

A taxpayer who disagrees with a notice of final determination issued by the Department may petition for a contested case hearing before an administrative law judge at the Office of Administrative Hearings pursuant to Article 3 of Chapter 105B of the General Statutes. A taxpayer may not petition for a contested case hearing until the Department has issued a notice of final determination. Pursuant to G.S. 150B-23(f), the petition for a contested case hearing must be filed within sixty (60) days of the date the Department mails or personally delivers the notice of final determination. The taxpayer does not have to pay the additional tax due prior to the contested case hearing.

For information about the contested tax case hearings process, please consult the Office of Administrative Hearings web page at [www.ncoah.com](http://www.ncoah.com).

#### **11. Judicial Review of Decision After Contested Case Hearing (G.S. 105-241.16)**

A taxpayer who receives an unfavorable decision in a contested case hearing may appeal the decision by filing a petition for judicial review with the Superior Court of Wake County and a Notice of Designation to designate the case as a mandatory complex business case to be heard by the Business Court. The appeal must be filed within thirty (30) days after the receipt of the final decision for the contested case hearing. The taxpayer must pay the tax liability set forth in the final decision to appeal.

#### **12. Civil Action Challenging Statute as Unconstitutional (G.S. 105-241.17)**

A taxpayer who claims that a tax statute is unconstitutional may bring a civil action with the Superior Court of Wake County to determine the taxpayer's liability under that statute and file a Notice of Designation to designate the case as a mandatory complex business case to be heard by the Business Court. To bring a civil action, the

taxpayer must have exhausted the prehearing remedy by receiving a notice of final determination from the Department, commenced a contested case at the Office of Administrative Hearings, received a dismissal notice from the Office of Administrative Hearings, paid the tax, penalties and interest due pursuant to the Department's notice of final determination and filed the civil action within two years of the dismissal.

**13. Declaratory Judgments, Injunctions, and Other Actions Prohibited (G.S. 105-241.19)**

The remedies provided in G.S. 105-241.11 through G.S. 105-241.17 are the exclusive remedies for disputing the denial of a requested refund, the taxpayer's liability for the tax, or the constitutionality of a tax statute. All other actions, including a declaratory judgment and an injunction to prevent the collection of a tax, are barred.

**14. Delivery of Notices to the Taxpayer (G.S. 105-241.20)**

A notice of proposed denial of a refund, notice of proposed assessment, notice of collection, and notice of final determination mailed to a taxpayer are presumed to have been received by the taxpayer unless the taxpayer makes an affidavit to the contrary within ninety (90) days after the notice was mailed. If the taxpayer makes an affidavit, the notice is considered delivered on the date of the affidavit.

**15. Interest on Taxes (G.S. 105-241.21)**

The interest rate set by the Secretary applies to interest that accrues on overpayments and assessments of tax. The law requires the interest rate to be determined 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 January 1. The current rate of interest may be obtained by contacting the Department of Revenue.

Interest accrues on tax not paid by the original due date from the original due date until the date paid even though a taxpayer may have an extension of time for filing the return.

Interest on overpayments of franchise, income and gross premiums taxes accrues beginning forty-five (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. Interest on overpayments of all other types of taxes begins ninety (90) days after the date the tax was paid.

**16. Collection of Taxes (G.S. 105-241.22)**

The Department can collect a tax when 1) a taxpayer files a return showing tax due on the return and does not pay the amount shown due, 2) the Department sends a notice of collection after the taxpayer does not file a timely request for a review of a proposed assessment, 3) the taxpayer and the Department agree on a settlement concerning the amount of tax due. 4) the Department issues a notice of final determination with respect to a proposed assessment and the taxpayer does not file a timely petition for a contested case hearing, 5) a final decision is issued on a proposed assessment of tax after a contested case hearing, or 6) the Office of Administrative Hearings

dismisses a petition for a contested case for lack of jurisdiction because the issue is the constitutionality of a statute.

#### **17. Jeopardy Assessment and Collection (G.S. 105-241.23)**

The Department can, within the statute of limitations, immediately assess and collect any tax found to be due if the Department determines that collection of the tax is in jeopardy and immediate assessment and collection are necessary to protect the State's interest. In making a jeopardy collection, the Secretary may use any of the collections in G.S. 105-242 and is not required to wait any period of time before using these remedies. Within thirty (30) days after initiating a jeopardy collection, the Secretary must give the taxpayer the notice of proposed assessment.

Within five days after issuing a jeopardy assessment that is not the result of a criminal investigation or was not for a liability for the unauthorized substance tax, the Department is required to give the taxpayer a written statement of the basis for the jeopardy action. Within thirty (30) days after receipt of this written statement or, if the statement is received, within thirty (30) days after the statement was due, the taxpayer may request the Secretary to review the action taken. After receipt of this request, the Secretary must determine whether initiating the jeopardy collection was reasonable under all the circumstances and whether the amount assessed and collected was reasonable under all the circumstances. The Secretary must give the taxpayer written notice of this determination within thirty (30) days after the request.

Within ninety (90) days after the earlier of the date a taxpayer received or should have received a determination of the Secretary concerning a jeopardy collection under subsection (b) of this section, the taxpayer may bring a civil action seeking review of the jeopardy collection. The taxpayer may bring the action in the Superior Court of Wake County or in the county in North Carolina in which the taxpayer resides. Within twenty (20) days after the action is filed, the court must determine whether the initiation of the jeopardy collection was reasonable under the circumstances. If the court determines that an action of the Secretary was unreasonable or inappropriate, the court may order the Secretary to take any action the court finds appropriate. If the taxpayer shows reasonable grounds why the twenty-day limit on the court should be extended, the court may grant an extension of not more than forty (40) additional days.

### **B. Payment of Taxes by Electronic Funds Transfer (EFT) (G.S. 105-241)**

#### **1. EFT Payments Required**

The Department of Revenue requires taxpayers making tax payments in excess of certain dollar amounts to make payment by Electronic Funds Transfer (EFT). If the average amount of the taxpayer's required payments of tax is at least twenty thousand dollars (\$20,000) a month, the taxpayer is required to remit the tax by EFT. The twenty thousand dollars (\$20,000) threshold applies separately to each taxing schedule. The applicable period for a tax is a twelve-month period, designated by the Secretary, preceding the imposition or review of the payment requirement.

A corporation that is required under the Internal Revenue Code to pay its federal estimated corporate income tax by EFT must also pay its State estimated tax by EFT. A taxpayer that is required to prepay its utility franchise tax or piped natural gas excise tax must pay by EFT.

## **2. Notification & Assistance**

In each situation, corporations will be notified if they are required to make EFT payments. Once selected, corporations will make EFT payments for a minimum of one year or until released from that obligation by the Department. If the tax liability falls below the threshold, the corporations will be notified that they are no longer required to pay by EFT. If there are questions or you need assistance, you may reach the Department's EFT Help Line at 1-877-308-9103 or (919) 733-7307.

## **3. Penalties, G.S. 105-236**

If a taxpayer is required to make payments by EFT, but remits payment in another form, a penalty of five percent (5%) of the amount of tax (maximum of one thousand dollars (\$1,000)) will be assessed.

If a taxpayer cannot complete a transfer as a result of insufficient funds or the nonexistence of an account, a penalty for bad electronic funds transfer of ten percent (10%) of the amount of tax (maximum of one thousand dollars (\$1,000)) will be assessed.

## **C. Penalties and Interest (G.S. 105-228.90 through G.S. 105-236, G.S. 105-241.21, G.S. 105-253)**

### **1. General**

The North Carolina Statutes provide both civil and criminal penalties for failure to comply with the tax laws.

In addition to any applicable penalty, all assessments of taxes or additional taxes bear interest at the rate established pursuant to G.S. 105-241.21.

### **2. 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 without payment of the tax shown due, both the late filing and late payment penalties will be assessed at the same time.

The penalty for failing to file any return on the date it is due, is equal to five percent (5%) of the amount of the tax if the failure is for not more than one month, with an additional five percent (5%) for each additional month, or fraction thereof, until the return is filed. If the return is filed under extension, the late filing penalty will be assessed from the extended filing date rather than from the original due date. The penalty shall not exceed twenty-five percent (25%) of the tax due or be less than five dollars (\$5.00). Failure to file any return by the date it is due could result in the suspension of the taxpayer's Articles of Incorporation or Certificate of Authority.

The late payment penalty is the greater of five dollars (\$5.00) or ten percent (10%) of the tax not paid by the original due date of the return and will apply on any remaining balance due if the tax paid by the original due date of the return is less than ninety percent (90%) of the total amount of tax due. If the ninety percent (90%) rule is met, any remaining balance due, including interest, must be paid with the tax return on or before the expiration of the extension period to avoid the late payment penalty.

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 ten percent (10%) late payment penalty if payment of the tax is not received within forty-five (45) days of the assessment.

The failure of officers, trustees and receivers to pay taxes due or accrued before allowing funds in their custody to be paid out is subject to the penalty policy of the Department.

### **3. Penalty for Bad Check**

When any uncertified check submitted to the Department of Revenue by a taxpayer is returned because of insufficient funds or the nonexistence of an account of the drawer, a penalty equal to ten percent (10%) of the check is assessed. The penalty shall not be less than one dollar (\$1.00) or more than one thousand dollars (\$1,000). This penalty does not apply if the Secretary finds that, when the check was presented for payment, the drawer of the check had sufficient funds in an account at a financial institution to pay the check and, inadvertently, failed to draw the check on the account that had sufficient funds.

### **4. Penalty for Bad Electronic Funds Transfer**

When an electronic funds transfer cannot be completed due to insufficient funds or the nonexistence of an account of the transferor, a penalty equal to ten percent (10%) of the amount of the transfer will be assessed. The penalty shall not be less than one dollar (\$1.00) or greater than one thousand dollars (\$1,000).

### **5. Making Payment in Wrong Form**

If a taxpayer makes a payment of tax in a form other than the form required by the Secretary a penalty equal to five percent (5%) of the amount of the tax will be assessed. The penalty shall not be less than one dollar (\$1.00) or greater than one thousand dollars (\$1,000).

### **6. Negligence Penalties**

If a taxpayer fails to comply with the tax laws, without intent to defraud, a penalty equal to ten percent (10%) of any tax deficiency is assessed. However, if the tax liability is understated by twenty-five percent (25%) or more, the penalty is twenty-five percent (25%) of the tax deficiency.

A negligence penalty cannot be assessed when the fraud penalty has been assessed with respect to the same deficiency. There is no minimum dollar amount of negligence penalty.

**7. Failure to Report Federal Changes**

Any taxpayer that receives a federal revenue agent's report or other final determination of taxable income and fails to report these federal changes within six months from the date of receipt of the federal report or determination is subject to the failure to file penalty and forfeits the right to any refund as a result of the federal changes. The failure to file penalty begins at the expiration of the six-month period.

**8. Fraud**

If there is a deficiency or delinquency in payment of any tax because of fraud with intent to evade the tax, a penalty equal to fifty percent (50%) of the total deficiency is assessed.

**9. Criminal Penalties**

Any taxpayer that willfully attempts, or any person who aids or abets any taxpayer to attempt in any manner, to evade or defeat a tax or its payment, shall, in addition to other penalties provided by law, be guilty of a Class H felony.

Any taxpayer required to pay any tax, to file any return, to keep any records, or to supply any information, that willfully fails to pay the tax, file the return, keep the records, or supply the information, at the time or times required by law, or rules pursuant thereto, shall, in addition to other penalties provided by law, be guilty of a Class 1 misdemeanor. Notwithstanding any other provision of law, no prosecution for a violation brought under this subdivision shall be barred before the expiration of six years after the date of the violation.

Any person, pursuant to or in connection with the revenue laws, who willfully aids, assists in, procures, counsels, or advises the preparation of a return, affidavit, claim, or any other document that the person knows is fraudulent or false as to any material matter, whether or not the falsity or fraud is with the knowledge or consent of the person authorized or required to present or file the return, affidavit, claim, or other document, shall be guilty of a Class H felony.

Any officer, agent, and/or employee of any person, firm or corporation subject to the revenue laws of this State, who willfully fails, refuses, or neglects to make out, file, and/or deliver any reports or blanks, as required, or to answer any question in the reports or blanks, or who knowingly and willfully gives a false answer to any question that is within the scope of his/her knowledge, or refuses to make any information requested available shall be guilty of a Class 3 misdemeanor and assessed a fine of not less than one hundred dollars (\$100) or more than one thousand dollars (\$1,000) for each offense.

**10. Collection Assistance Fee**

Any assessment not paid within ninety (90) days after it becomes collectible has been mailed is subject to a twenty percent (20%) collection assistance fee. The fee will not apply if payments are being made pursuant to an installment agreement that became effective within ninety (90) days after it becomes collectible.

**11. 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 on overpayments accrues beginning forty-five (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 interest rate to be determined 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 January 1. The current rate of interest is available at the Department of Revenue's website, [www.dornrc.com](http://www.dornrc.com).

**12. Underpayment of Estimated Income Tax**

The computation of interest due for underpayment of estimated income tax should be made on Form CD-429B. A taxpayer does not need to file this form with the return to which it pertains, but should include any interest due in the payment of tax due.

**13. Waiver of Penalty**

Any penalty may be waived by the Secretary of Revenue pursuant to the Department of Revenue penalty policy. A request for waiver or reduction of penalty must be in writing and must include an explanation for the request. The Department's Penalty Waiver Policy and form to request waiver (Form NC-5500) are available on the Department's website, [www.dornrc.com](http://www.dornrc.com). Interest on the tax cannot be waived or reduced.

**Exception:** Penalties assessed as the result of a taxpayer engaging in tax strategies whereby income that would otherwise be taxable in North Carolina is shifted out-of-state or in other tax shelter activities that reduce or eliminate North Carolina state laws will not be waived for any reason.

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