Important Notice: North Carolina’s Reference to the Internal Revenue Code Updated - Impact on North Carolina Corporate and Individual Income Tax Returns

On June 30, 2020, Governor Cooper signed into law Session Law 2020-58 (House Bill 1080). This legislation updated North Carolina’s reference to the Internal Revenue Code (the “Code”) from January 1, 2019, to May 1, 2020. This means changes made to the Code as of May 1, 2020, including changes made by the Further Consolidated Appropriations Act of 2020 (“FCAA”) and the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), (collectively, “federal tax provisions”) apply when calculating an individual’s or corporation’s State income tax liability to the extent North Carolina follows the federal tax provisions and does not decouple from the changes.

The purpose of this notice is to identify and explain the decoupling of North Carolina law from certain federal tax provisions in the FCAA and CARES Act. If the decoupling provisions impact a taxpayer’s State income tax liability, specific instructions are provided for completing, or amending, the 2019 corporate or individual income tax return. Any impact to the 2020 corporate or individual income tax returns will be addressed in the instructions for the 2020 income tax returns, which should be released in early January 2021.

Importantly, certain federal tax provisions do not apply to North Carolina because of previously existing differences between federal and State law including: (1) North Carolina begins with federal adjusted gross income (“AGI”) instead of federal taxable income (“FTI”), (2) North Carolina does not conform to the federal standard deduction amount (3) North Carolina does not conform to federal itemized deductions, and (4) North Carolina does not conform to federal bonus depreciation or larger Section 179 limits.

### Decoupling Provisions Impacting Individuals

<table>
<thead>
<tr>
<th>Mortgage Insurance Premiums</th>
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<tr>
<td><strong>Federal Provision</strong> – Extended the treatment of mortgage insurance premiums as qualified residence interest through tax year 2020.</td>
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<tr>
<td><strong>State Provision</strong> – Mortgage insurance premiums are not treated as qualified residence interest.</td>
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<tr>
<td><strong>2019 Individual Income Tax Return</strong> – You must not include the amount of mortgage insurance premium on Form D-400 Schedule S, Part C, Line 16.</td>
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1. The Department issued an important notice dated July 9, 2020, to address the enhanced medical and dental expense deduction threshold for tax year 2019.
2. Provisions 1, 2, and 3 apply only to individual income tax. Provision 4 applies to both individual and corporate income tax.
### Decoupling Provisions Impacting Individuals (continued)

#### Cancellation of Qualified Principal Residence Indebtedness

- **Federal Provision** – Continued to exclude from gross income the cancellation of qualified principal residence debt through tax year 2020.

- **State Provision** – Cancelation of qualified principal residence debt is included in the calculation of NC taxable income through tax year 2020.

- **2019 Individual Income Tax Return** – You must include the cancelation of debt income on Form D-400 Schedule S, Part A, Line 5.

#### Qualified Tuition and Related Expenses

- **Federal Provision** – Extended the deduction for qualified tuition and related expenses through tax year 2020.

- **State Provision** – Qualified tuition and related expenses are not deductible.

- **2019 Individual Income Tax Return** – You must include the amount of qualified tuition and related expenses on Form D-400 Schedule S, Part A, Line 5.

#### Net Operating Loss (“NOL”) Carryback Incurred in Tax Years 2018, 2019, and 2020

- **Federal Provision** – Provided a five (5) year carryback for NOLs incurred in tax years 2018, 2019, and 2020.

- **State Provision** – An NOL incurred in 2018, 2019, and 2020 carried back for federal tax purposes must be added to a taxpayer’s AGI for tax years 2013 through 2019. Farming losses under the provisions of Code § 172(b)(1)(B) do not need to be added under this provision.

  **Note.** The amount added back to a taxpayer’s AGI may be deducted in five equal installments beginning in tax year 2021.

- **2019 Individual Income Tax Return** – You must add the amount of loss that originated in tax year 2020 used to offset your 2019 federal AGI to Form D-400 Schedule S, Part A, Line 5.
Decoupling Provisions Impacting Individuals (continued)

### NOL Limit of Eighty Percent of Taxable Income for Tax Years 2018, 2019, and 2020

- **Federal Provision** - Suspended the 80% NOL carryforward deduction limitation under Code § 172 until tax year 2021 for NOLs incurred during tax years 2018, 2019, and 2020.

- **State Provision** – An NOL carryforward deduction taken in tax years 2019 or 2020 resulting from an NOL incurred in tax years 2018 or 2019 income must be added to a taxpayer’s AGI to the extent that the federal deduction exceeds the amount allowed under the provisions of Code § 172 as enacted as of January 1, 2019.

  **Note.** The amount added back to a taxpayer’s AGI may be deducted in five equal installments beginning in tax year 2021.

- **2019 Individual Income Tax Return** – You must add the amount by which the 2018 NOL carryforward deduction exceeds the amount allowed under the provisions of Code § 172(a)(2)(B) as enacted as of January 1, 2019 to Form D-400 Schedule S, Part A, Line 5.

### Business Interest Expense Limitation

- **Federal Provision** – Increased the limit on deductions for business interest expense under Code § 163(j) from 30% to 50% of a taxpayer’s adjusted taxable income for tax years 2019 and 2020.

- **State Provision** – The business interest expense deduction under Code § 163(j) remains at 30% of adjusted taxable income.

- **2019 Individual Income Tax Return** – You must add the amount of business interest expense deducted on the federal return in excess of the 30% of adjusted taxable income limitation on Form D-400 Schedule S, Part A, Line 5.

### Excess Business Loss Limitation for Tax Years 2018, 2019, and 2020
(Updated October 1, 2020)


- **State Provision** – The amount of taxpayer’s excess business loss, as defined under the provisions of Code § 461(l) as enacted as of January 1, 2019, for tax years 2018 through 2020 must be added to a taxpayer’s AGI. This addition does not apply to the extent a taxpayer’s excess business loss was included as an addition under 105-153.5(c2)(8), (9), or (10).
### Decoupling Provisions Impacting Individuals (continued)

Federal law provides Qualified Improvement Property (“QIP”) placed in service after 2017 now generally qualifies for 100% bonus depreciation under the CARES Act. North Carolina requires a taxpayer to add back federal bonus depreciation in accordance with G.S. § 105-153.6. QIP bonus depreciation should not be included in the calculation of the taxpayer’s excess business loss to the extent the QIP bonus depreciation resulted in an addition to a taxpayer’s AGI pursuant to G.S. § 105-153.6(a).

**Note.** The amount added back to a taxpayer’s AGI may be deducted in five equal installments beginning in tax year 2021.

- **2019 Individual Income Tax Return** – You must add the amount of your excess business loss to Form D-400 Schedule S, Part A, Line 5.

### Payment Protection Program Loan Forgiveness and Expense Deductions

- **Federal Provision** - Excluded the amount of a forgiven Payment Protection Program (“PPP”) loan from gross income.

- **State Provision** – Amount of forgiven PPP loan is not included in the calculation of NC taxable income. However, any expenses paid using the proceeds of the PPP loan that are deducted for federal tax purposes are not deductible when calculating NC taxable income.

- **2019 Individual Income Tax Return** – You must add the amount of any expenses deducted on your federal return on Form D-400 Schedule S, Part A, Line 5 if (1) the payment of the expenses result in PPP loan forgiveness, and (2) you excluded from gross income the amount of forgiven PPP loan.

### Limitation on Charitable Contributions

- **Federal Provision** – Suspended the IRC § 170 limit on charitable contributions (60% of AGI) for tax year 2020.

- **State Provision** – The IRC § 170 60% of AGI limit on charitable contributions remains in effect for tax year 2020.

### Employer Payments of Student Loans

- **Federal Provision** - Excluded certain employer payments of student loans under IRC § 127(c) from gross income for tax year 2020.
## Decoupling Provisions Impacting Individuals (continued)

- **State Provision** – Employer payments of student loans under Code § 127(c) are included in NC taxable income for tax year 2020.

### Above-the-Line Deduction for Qualified Charitable Contributions

- **Federal Provision** – Created an above-the-line deduction for qualified charitable contributions for tax year 2020 under section 2204 of the CARES Act.

- **State Provision** – The amount of the above-the-line deduction taken for qualified charitable contributions under section 2204 of the CARES Act must be added back to adjusted gross income for tax year 2020.

## Decoupling Provisions Impacting Corporations

### Business Interest Expense Limitation

- **Federal Provision** – Increased the limit on deductions for business interest expense under Code § 163(j) from 30% to 50% of taxpayer’s adjusted taxable income for tax years 2019 and 2020.

- **State Provision** – The business interest expense deduction under Code § 163(j) remains at 30% of adjusted taxable income as calculated on a separate entity basis.

- **2019 C-Corporation Income Tax Return** – You must add the amount of business interest expense deducted on the federal return in excess of the 30% of adjusted taxable income limitation on Form CD-405, Schedule H, Line 1.h.

### Payment Protection Program Loan Forgiveness and Expenses

- **Federal Provision** - Excluded the amount of a forgiven Payment Protection Program ("PPP") loan from gross income.

- **State Provision** – Amount of forgiven PPP loan is not included in the calculation of NC taxable income. However, any expenses paid using the proceeds of the PPP loan that are deducted for federal tax purposes are not deductible when calculating NC taxable income.
Decoupling Provisions Impacting Corporations (continued)

- 2019 C-Corporation Income Tax Return – You must add the amount of any expenses deducted on your federal return on Form CD-405, Schedule H, Line 1.h if (1) payment of the expenses result in PPP loan forgiveness, and (2) you excluded from gross income the amount of forgiven PPP loan.

Amended Returns

If you have already filed a 2019 North Carolina income tax return and your federal adjusted gross income (for individuals) or federal taxable income (for corporations) is impacted by the amendments to federal law included in FCAA and CARES Act or by the provisions of federal law from which North Carolina has decoupled, you must file an amended North Carolina return. If the amended return reflects additional tax due, you will avoid a late-payment penalty provided the additional tax reflected on the amended return is paid when the amended return is filed. If the amended return reflects additional tax due but some or all of the additional tax is not paid when the amended return is filed, the unpaid tax is subject to applicable penalties. In addition, statutory interest accrues on tax not paid by the original due date of the tax return. Taxpayers that owe additional North Carolina income tax may request a waiver of penalties within the provisions of the Department’s Penalty Waiver Policy.

Assistance

If you have any questions about this notice, you may call the North Carolina Department of Revenue Customer Interaction Center at 1-877-252-3052 (8:00 am until 5:00 pm EST, Monday through Friday), or write the Department at PO Box 1168, Raleigh, NC 27602. Additional information on new legislation affecting North Carolina taxes may be obtained from the Department’s annual law change document. When published, the 2020 law change document will be available on the Department’s website, www.ncdor.gov.

To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this notice and issued prior to this notice conflict with this notice, the provisions contained in this important notice supersede the previous guidance.