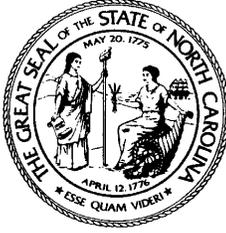

North Carolina Department of Revenue



DIRECTIVE

Subject: Franchise Tax - Definition of a Holding Company
Tax: Franchise Tax
Law: N.C. Gen. Stat. § 105-120.2(c)(2)
Issued By: Corporate Tax Division
Date: March 6, 2018
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Purpose

The North Carolina Department of Revenue ("Department") has received several inquiries regarding the computation of gross income from corporations in determining whether a taxpayer meets the definition of a "holding company" under N.C. Gen. Stat. § 105-120.2 in calculating a corporation's annual franchise tax liability. Specifically, should a taxpayer compute "gross income" from corporations on a legal entity basis or as computed for corporate income tax purposes in applying the test in N.C. Gen. Stat. § 105-120.2(c)(2)?

Statutory Authority

N.C. Gen. Stat. § 105-122 requires every corporation that is incorporated, domesticated, or doing business in the state to pay a franchise tax. The tax is imposed on the largest of three bases: 1) the value of the corporation's net worth apportioned to North Carolina (the "net worth base"); 2) the value of the corporation's investment in North Carolina tangible property (the "tangible property base"); or 3) fifty-five percent (55%) of the appraised value of the corporation's North Carolina tangible property (the "appraised value base"). The tax is levied at the rate of \$1.50 per \$1000 of the largest of the three bases, with a minimum of \$200.

The franchise tax payable by a corporation that is classified as a "holding company" pursuant to N.C. Gen. Stat. § 105-120.2 is limited to \$150,000 when levied on its net worth base. There is no maximum limitation of franchise tax payable on a corporation's net worth base when a corporation does not meet the holding company definition. Also, if the franchise tax is determined from either the tangible property base or the appraised value base, there is not a maximum limitation of franchise tax payable by a corporation that is classified as a holding company.

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In determining if a corporation meets the definition of a holding company the Department relies upon N.C. Gen. Stat. § 105-120.2(c), which provides that:

For purposes of this section, a 'holding company' is a corporation that satisfies at least one of the following conditions:

- (1) It has no assets other than ownership interests in corporations in which it owns, directly or indirectly, more than fifty percent (50%) of the outstanding voting stock or voting capital interests.
- (2) It receives during its taxable year more than eighty percent (80%) of its gross income from corporations in which it owns directly or indirectly more than fifty percent (50%) of the outstanding voting stock, voting capital interests, or ownership interests.

The inclusion of the phrase "gross income from corporations" in the holding company definition in N.C. Gen. Stat. § 105-120.2(c)(2) is subject to interpretation because a definition of the phrase "gross income" is not specifically provided for in Article 3. However, gross income is defined for corporate income tax purposes. N.C. Gen. Stat. § 105-130.2(9) defines gross income for corporate income tax purposes as follows:

"Gross income. – Defined in section 61 of the [Internal Revenue] Code."

Section 61 of the Internal Revenue Code states, in part:

"...gross income means all income from whatever sourced derived..."

Discussion

Because the definition of gross income is not defined in Article 3 but in Part 1 of Article 4, the Department's interpretation of N.C. Gen. Stat. § 105-120.2(c)(2) is that corporate income tax principles for computing "gross income from corporations" is applicable for determining whether a corporation qualifies as a holding company. Further, because the Department's definition of gross income refers to the Internal Revenue Code and the Department adopts these corporate income tax principles, the Department looks to the corporation's federal return for its gross income.

The Federal Form 1120 does not contain one specific line item to aggregate gross income. Accordingly, the Department looks to Federal Form 1120 lines 1-11 (as calculated on a separate entity basis for North Carolina purposes) to establish a corporation's total income under Section 61 of the Internal Revenue Code, and

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determine whether a corporation qualifies under the gross income test of N.C. Gen. Stat. § 105-120.2(c)(2).

Therefore, in determining whether a corporation receives 80% of its income under N.C. Gen. Stat. § 105-120.2(c)(2), the recipient corporation's income would include income items from a disregarded limited liability company ("LLC") because the LLC does not file a separate federal or State tax return, and these amounts of gross income are included in the Federal Form 1120 (as calculated on a separate entity basis for North Carolina purposes). Correspondingly, in determining the source of the gross income received, the Department would apply similar corporate income tax principles. Therefore, amounts received from a corporation meeting the ownership tests in N.C. Gen. Stat. § 105-120.2(c)(2) would include gross income items from any disregarded LLCs of that corporation in calculating whether the recipient corporation meets the more than 80% of gross income requirement in N.C. Gen. Stat. § 105-120.2(c)(2).

Questions

Questions regarding this Directive may be directed to the Corporate Tax Division at (919) 814-1163 or you may write to the Corporate Tax Division at P.O. Box 871, Raleigh, NC 27602-0871.