

## DIRECTIVE

**Subject:** Changes That Allow Certain Trusts and Corporations to be Eligible Partners in a Taxed Partnership  
**Tax:** Partnership Tax  
**Law:** N.C. Gen. Stat. § 105-154.1  
**Issued By:** Personal Taxes Division  
**Date:** October 4, 2023  
**Revised:** **May 16, 2024**  
**Number:** TA-23-1

The following important information is addressed in this directive:

- An explanation of how a provision included in Session Law 2023-134 expanded the list of eligible partners for a partnership that is allowed to elect to be taxed for North Carolina income tax purposes at the partnership level (“Taxed Partnership Election”).
- Information on a special provision included in **Session Law 2024-1** that allows an eligible partnership to amend its North Carolina Partnership Income Tax Return (“NC Partnership Tax Return”) for tax year 2022 to make the Taxed Partnership Election.
- Important reminders for partnerships that are eligible to make the Taxed Partnership Election for tax year 2022.

### **Background**

[Session Law 2023-134](#) (House Bill 259) became law on October 3, 2023. This legislation included a provision that updates North Carolina’s pass-through entity (“PTE”) tax to allow certain trusts and corporations to be partners in a Taxed Partnership effective for taxable years beginning on or after January 1, 2022.<sup>1</sup> The purpose of this directive is to provide an overview of this important retroactive change.

### **Expanded Taxed Partnership Eligibility**

Prior to the enactment of Session Law 2023-134, [N.C. Gen. Stat. § 105-154.1\(a\)](#)<sup>2</sup> did not allow a partnership to make the Taxed Partnership Election if it had, at any time during the taxable year, a partner who was not one of the following:

- (1) An individual.
- (2) An estate.
- (3) A trust described in section 1361(c)(2) of the Code.
- (4) An organization described in section 1361(c)(6) of the Code.
- (5) A partnership including an entity that is classified as a partnership for federal income tax purposes, or an S Corporation as defined in [N.C. Gen. Stat. § 105-131\(b\)](#).

<sup>1</sup> For more information on North Carolina’s pass-through entity tax, see the Department’s [Important Notice dated April 14, 2022](#). Terms defined in that notice will also be used in this Directive.

<sup>2</sup> See SB 174, s. 1.5.(b); [S.L. 2023-12](#). See also the [Department’s Important Notice dated April 4, 2023](#).

Newly Qualifying Trust Partner

[Session Law 2023-134](#) rewrote subdivision (3) of [N.C. Gen. Stat. § 105-154.1\(a\)](#) to read as follows:

- (3) Any of the following:
- a. A trust described in section 1361(c)(2) of the Code.
  - b. **A trust if such trust does not have as a beneficiary any person other than an individual, an estate, a trust, or an organization described in section 1361(c)(6) of the Code.**

*Emphasis added.*

Because of this modification, additional trusts now qualify as eligible partners for purposes of the Taxed Partnership Election. In particular, a partnership that includes a trust which is not described in Internal Revenue Code (“Code”) § 1361(c)(2) is eligible to make the Taxed Partnership Election if the trust does not have as a beneficiary any person other than an individual, an estate, a trust, or an organization described in Code § 1361(c)(6) (“Qualifying Trust Partner”).

Because the North Carolina taxable income of a Taxed Partnership is calculated based on the partners listed in N.C. Gen. Stat. §§ 105-154.1(a)(1) through 105-154.1(a)(4), a Taxed Partnership with a Qualifying Trust Partner will include that partner’s distributive share in its calculation of North Carolina’s PTE tax.<sup>3</sup>

Newly Qualifying Corporate Partner

[Session Law 2023-134](#) also rewrote subdivision (5) of N.C. Gen. Stat. § 105-154.1(a) to read as follows:

- (5) A partnership, including an entity that is classified as a partnership for federal income tax purposes, **or an entity that is classified as a corporation for federal income tax purposes.**

*Emphasis added.*

This modification allows **any** entity classified as a corporation for federal income tax purposes to be an eligible partner for purposes of the Taxed Partnership Election (“Qualifying Corporate Partner”). Under prior law, only an S Corporation was considered an eligible partner.<sup>4</sup>

As mentioned earlier, the taxable income of a Taxed Partnership is calculated based on the partners listed in N.C. Gen. Stat. §§ 105-154.1(a)(1) through 105-154.1(a)(4). Because a Qualifying Corporate Partner is listed under N.C. Gen. Stat. § 105-154.1(a)(5), a Taxed

<sup>3</sup> See SB 174, s. 1.5.(c); [S.L. 2023-12](#). See also the Department’s [Important Notice dated April 4, 2023](#).

<sup>4</sup> See SB 174, s. 1.5.(b); [S.L. 2023-12](#). See also the Department’s [Important Notice dated April 4, 2023](#).

Partnership with a Qualifying Corporate Partner **will NOT** include that partner's distributive share in its calculation of North Carolina's PTE tax.

### **Extension of Time to Make the Taxed Partnership Election for Tax Year 2022**

A partnership that could not make the Taxed Partnership Election for tax year 2022 because the partnership had a partner not listed under subsection (a) of [N.C. Gen. Stat. § 105-154.1](#) as originally enacted<sup>5</sup> can now make the Taxed Partnership Election if all of its partners are listed under N.C. Gen. Stat. § 105-154.1(a) as amended by [Session Law 2023-134](#). Significantly, a partnership that previously filed a NC Partnership Tax Return ("[Form D-403](#)") for tax year 2022 can **only** make the Taxed Partnership Election if:

- The partnership filed Form D-403 on or before the due date of the return, including extensions, and
- The partnership files an amended return making the Taxed Partnership Election on or before **July 1, 2024**.<sup>6</sup> A Taxed Partnership Election made on an amended return for tax year 2022 filed after **July 1, 2024**, is **NOT** valid.

### **Important Reminders**

The amended return for a Taxed Partnership with a Qualifying Trust Partner must be completed in accordance with the instructions provided in [Form D-403A](#) for tax year 2022. However, the amended return for a Taxed Partnership with a Qualifying Corporate Partner must be completed in accordance with the instructions provided in the Department's [Important Notice dated April 4, 2023](#). Moreover, if a partnership files an amended Form D-403 to make the Taxed Partnership Election, the Taxed Partnership must furnish each partner with an updated [Form NC K-1](#) for tax year 2022 if the information originally reported to the partner has changed.

In addition, a partnership that is eligible to make the Taxed Partnership Election for tax year 2022 but has not filed its NC Partnership Tax Return must make the election by the due date of the partnership's return, including extensions. A Taxed Partnership Election on a late-filed NC Partnership Tax Return is not valid.<sup>7</sup>

### **Future Impacts and Assistance**

If you have any questions about this directive, you may call the North Carolina Department of Revenue Customer Service line at 1-877-252-3052 (7:00 am until 4:30 pm EDT, Monday through Friday), or write to Customer Service, PO Box 1168, Raleigh, NC 27602-1168.

*To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this directive, this directive 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 directive and issued prior to this directive conflict with this directive, the provisions contained in this directive supersede the previous guidance.*

<sup>5</sup> See SB 105, s. 42.5.(h); [S.L. 2021-180](#).

<sup>6</sup> See **SB 508**, s. 11.3.(a); [S.L. 2024-1](#).

<sup>7</sup> See the Department's [Important Notice dated April 14, 2022](#).