



# **CORPORATE INCOME, FRANCHISE, AND INSURANCE TAX BULLETIN**

**Reflecting Changes Made in the 2025 Regular Session  
of the North Carolina General Assembly**

**Issued by:**

**Corporate Tax Division  
Tax Administration  
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## **PREFACE**

The Corporate Income, Franchise, and Insurance Tax Bulletin was prepared for the purpose of presenting the administrative interpretation and application of North Carolina corporate income, franchise, and insurance premiums tax laws at the time of publication. This publication supplements information provided in the Administrative Rules but does not supersede the Administrative Rules. In addition, this bulletin does not cover all provisions of the law.

Taxpayers are cautioned that this publication is intended merely as a guide and that consideration must be given to all the facts and circumstances in applying this Bulletin to particular situations. Taxpayers using this publication should be aware that additional changes may result from legislative action, court decisions, and rules adopted or amended under the Administrative Procedure Act, Chapter 150B of the General Statutes. To the extent there is any change to a statute, administrative rule, or new case law subsequent to the date of this publication, the provisions in this bulletin may be superseded or voided. Unless otherwise noted, this Bulletin is intended to reflect changes made in the 2025 regular session of the North Carolina General Assembly.

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## **I. FRANCHISE TAX (Article 3)**

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

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

North Carolina levies a franchise tax upon corporations, both domestic and foreign, and upon certain partnerships and limited liability companies (“LLCs”). The tax levied in this Article is 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. § <a href="#">105-114.1</a>	Limited liability companies
G.S. § <a href="#">105-120.2</a>	Holding companies
G.S. § <a href="#">105-122</a>	General business corporations
G.S. § <a href="#">105-125</a>	Exempt corporations

Effective August 1, 2019, a nonresident business is not subject to franchise tax if the nonresident business derives income in North Carolina solely from performing disaster-related work during a disaster response period at the request of a critical infrastructure company. See [Appendix A](#) for more information on the disaster relief provisions provided in G.S. § 166A-19.70A, including applicable definitions, limitations, and notifications required to qualify for the tax and filing exclusion.

The tax levied upon corporations organized under the laws of North Carolina (domestic corporations) is 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) is 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.

#### **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 or partnerships that elect to be taxed as 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**

Tax levied under this Article 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 to an annual minimum franchise tax of two hundred dollars (\$200). Failure to file this return and pay the minimum tax will result in the 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. Voluntary Dissolution or Withdrawal of Corporate Rights (G.S. § [105-127\(f\)](#))**

Corporations are not subject to franchise tax after the end of the income year in which articles of dissolution or withdrawal are voluntarily 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 voluntarily files articles of dissolution or withdrawal during the calendar year 2019. Although its final income tax return will be filed on a franchise and income tax return, the franchise tax portion of the return need not be completed since the franchise tax applicable to calendar year 2019 was reported on the 2018 tax return.

*Example 2:* A corporation using an income year ending April 30 voluntarily files articles of dissolution or withdrawal on May 19, 2019. Although its final income tax return will be filed on a franchise and income tax return, the franchise tax portion of the return need not be completed since the franchise tax applicable to the income year beginning May 1, 2019, was reported on the tax return for the income year ended April 30, 2019.

A corporation is not entitled to a partial refund of franchise tax paid if the corporation files articles of dissolution or withdrawal during the year.

#### **7. Payment of Franchise Taxes (G.S. § [105-122\(a\)](#))**

Franchise tax is due on the statutory filing date of the return, without regard to extensions.

#### **8. Extension of Filing Date ([17 NCAC 05B .0107](#), G.S. § [105-263](#))**

A corporation subject to the franchise tax may obtain an extension of time for filing its franchise tax return. For tax years beginning on or after January 1, 2008, and before January 1, 2025, the extension of time is six (6) months from the original due date of the return. For

tax years beginning on or after January 1, 2025, the extension of time is seven (7) months from the original due date of the return.

A corporation that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina franchise and income tax return. To receive an automatic State extension, the corporation must certify on the North Carolina tax return that the corporation was granted an automatic federal extension. The automatic extension only applies to extension applications filed by a corporation with the Commissioner of Internal Revenue. The automatic extension does not apply to extensions granted under section 7508A of the Code because of a presidentially declared disaster.

A corporation that is not granted an automatic extension to file a federal income tax return must file Form CD-419 by the original due date of the return to receive an extension for North Carolina franchise and income tax purposes. Form CD-419 is available at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

An extension of time for filing a franchise tax return does not extend the time for paying the tax due or the time when a penalty attaches for failure to pay the tax. For additional detailed information concerning the requirements for obtaining an extension of time for filing a corporate franchise and income tax return, *see “Extension of Time for Filing Return” in [Section II, Corporate Income Tax](#).*

## **9. Tax Credit for Limited Liability Companies Subject to Franchise Tax (G.S. § [105-122.1](#))**

LLCs that elect to be taxed as 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. § [57D-1-22](#). 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.

*Example:* An LLC that has elected to be taxed as a corporation computes its franchise tax due to be \$500. Because the fee for an LLC under G.S. § [57D-1-22](#) is \$200, while the fee for a corporation filing a paper annual report under G.S. § [55-1-22\(a\)\(23\)](#) is \$25, a credit of \$175 is allowed to the LLC against franchise tax.

## **B. [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 tax year from corporations in which it owns, directly or indirectly, more than fifty percent (50%) of the outstanding voting stock, voting capital interest, or ownership interests. A corporation will also qualify for holding company status if it has no

assets other than ownership interests in corporations in which it owns, directly or indirectly, more than 50% of the outstanding stock or voting capital interests.

If a holding company has an ownership interest in an LLC doing business in the State and the LLC is taxed as a 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.

The definition of a holding company also includes a corporation that meets all of the following criteria:

- a. Is one hundred percent (100%) directly owned by a corporation that is a manufacturer as defined by NAICS codes 31 through 33;
- b. Receives more than eighty percent (80%) of its income from royalties and fees, or more than eighty percent (80%) of its total assets are copyrights, patents, or trademarks;
- c. Generates more than five billion dollars (\$5,000,000,000) in revenue for income tax purposes from goods it manufactures; and
- d. Includes an investment in the holding company in its net worth franchise tax base.

For more information on the definition of a holding company, see *Directive, [CD-18-1 “Franchise Tax – Definition of a Holding Company”](#)*.

## **2. Basis for Taxation**

The basis of the tax for a holding company is the same as for general business corporations. However, franchise tax payable by a qualified holding company on its net worth base is limited to one hundred and fifty thousand dollars (\$150,000). 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.

## **C. [General Business Corporations \(G.S. § 105-122\)](#)**

### **1. Basis for the Tax**

For tax years beginning on or after January 1, 2023, the basis of the tax is determined by the net worth of the taxpayer. Corporations doing business both within and without North Carolina are required to apportion their net worth to North Carolina in accordance with a specified statutory apportionment formula.

### **2. Franchise Tax Calculation**

For tax years beginning on or after January 1, 2023, franchise tax is calculated using only the net worth tax base.

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

Unless specifically exempt under G.S. § [105-125](#), or under the disaster relief provision in G.S. § [105-114](#), 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 taxed as a 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 taxed as a 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. Forms to be used for Filing**

The franchise tax is filed on Form CD-405 for C corporations and Form CD-401S for S corporations. These forms, along with other required corporate forms and instructions, are available from the Department's website at:

<https://www.ncdor.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

### **5. 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 a taxpayer uses computer-generated returns, the software company is responsible for requesting and receiving an assigned barcode. The Department publishes a list of software developers that have received approval on the Department's website. 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.

### **6. Report and Payment Due**

Corporations must file returns annually on or before the fifteenth day of the fourth month following the end of the income year. The return is filed as a part of a joint franchise and income tax return. Payment of the entire amount of franchise tax is required by the statutory due date of the return, without regard to extensions.

## 7. Tax Rate

Except for an S Corporation as discussed below, the franchise tax rate is one dollar and fifty cents (\$1.50) per one thousand dollars (\$1,000) and is applied as set forth in the law.

Effective for tax years beginning on or after January 1, 2025, and applicable to the franchise tax reported on the 2024 and later tax returns:

A cap is set at five hundred (\$500) for the first one million dollars (\$1,000,000) of its franchise tax base and one dollar and fifty cents (\$1.50) per one thousand dollars (\$1,000) of its tax base that exceeds one million dollars (\$1,000,000).

For an S corporation, as defined in G.S. § 105-130.2, the franchise tax rate is two hundred dollars (\$200) for the first one million dollars (\$1,000,000) of the corporation's tax base and one dollar and fifty cents (\$1.50) per one thousand dollars (\$1,000) of its tax base that exceeds one million dollars (\$1,000,000) and is applied as set forth in the law.

The minimum franchise tax is two hundred dollars (\$200).

## 8. 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, 2021. The corporation has selected a calendar year end. The first tax return due on April 15, 2022, will be a short period return covering the income tax period from October 15, 2021, to December 31, 2021. Franchise tax due on this return covers the ensuing calendar year through December 31, 2022, for the privilege of doing business in North Carolina or for the privilege of existing as a corporation in North Carolina.

## D. [Net Worth Base \(G.S. § 105-122\(b\)\)](#)

### 1. Based on Year End Balance Sheet

Net worth is measured as of the end of the tax year using generally accepted accounting principles (“GAAP”). If the corporation does not use GAAP in maintaining its books and records, then net worth is computed using the same accounting method used for federal income tax purposes. The net worth of a foreign entity filing a federal income tax return is determined based on the value of the assets deemed to be in the United States.

### 2. Net Worth Defined

A corporation's net worth is defined as the total assets of the corporation without regard to deductions for accumulated depreciation, depletion, or amortization **minus** total liabilities.

### **3. Adjustments to Net Worth**

In determining net worth, the following adjustments are required:

- (a) A deduction for accumulated depreciation, depletion, or amortization allowed for federal income tax purposes.
- (b) Assets that are allowed a deduction for depreciation, depletion, or amortization for federal income tax purposes are valued under the same method used for computing depreciation, depletion, and amortization.
- (c) An addition for the amount of affiliated indebtedness owed to a parent, subsidiary, affiliate, or noncorporate entity in which the corporation or group of corporations owns directly or indirectly more than fifty percent (50%) of the capital interest of the noncorporate entity, unless the indebtedness creates qualified interest expense, as defined in G.S. §§ 105-130.7B(b)(4)(a) through 105-130.7B(b)(4)(d).
- (d) The creditor corporation that is subject to franchise tax may deduct the amount of indebtedness owed to it by a parent, subsidiary, or affiliated corporation to the extent such indebtedness has been added by the debtor corporation in computing its franchise tax liability.

### **4. Exclusion of Retained Earnings by Parent Corporation**

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**

No reduction of the net worth base is allowed for the investment in subsidiary except as provided in G.S. § 105-114.1(d).

### **6. Other Definitions**

In determining the net worth base, the following definitions apply:

- (a) Affiliate – A corporation is an affiliate of another corporation if both are controlled directly or indirectly by the same parent corporation or same or associated financial interests through stock ownership, interlocking directors, or by any other means whatsoever, whether the control is direct or through one or more subsidiary, affiliate, or controlled corporation.
- (b) Affiliated group – The same meaning as defined in G.S. § [105-114.1](#).
- (c) Capital interest – The right under the entity's governing law to receive a percentage of the entity's assets, after payments to creditors, if the entity was dissolved.

- (d) Governing law – The law under which the noncorporate entity was organized.
- (e) Indebtedness – All loans, credits, goods, supplies, or other capital of whatsoever nature furnished by a parent, a subsidiary, an affiliate, or a noncorporate entity in which the corporation or an affiliated group of corporations owns directly or indirectly more than 50% of the capital interests of the noncorporate entity. Indebtedness does not include amounts endorsed, guaranteed, or otherwise supported by one of the related corporations.
- (f) Noncorporate entity – a person that is neither a human being nor a corporation.
- (g) Parent – A corporation that directly or indirectly controls 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.
- (h) Subsidiary – A corporation that is directly or indirectly subject to control by another corporation by stock ownership, interlocking directors, or by any other means whatsoever exercised by the same or associated financial interest, whether the control is direct or through one or more subsidiary, affiliated, or controlled corporations.
- (i) Total assets – The sum of all cash, investments, furniture, fixtures, equipment, receivables, intangibles, and any other items of value owned by a person or a business entity.

## **E. Multistate Corporations (G.S. § 105-122(c1))**

### **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 net worth 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 net worth 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 net worth. Unless the Secretary specifically authorizes a modified method of allocation for franchise tax purposes, the statutory formula must be used.

A corporation that has made a State net loss election to apportion receipts from services based on the percentage of its income-producing activities performed in this State (under G.S. § [105-130.4\(t3\)](#)) is required to use the statutory apportionment method as if the election had not been made, unless they have been authorized to use an alternative apportionment formula. Thus, the apportionment factor for franchise tax may differ from corporate income tax if a corporation makes a State net loss election to apportion its receipts for corporate income tax purposes.

## **2. Alternative Apportionment Formula**

If any corporation believes that the statutory apportionment formula allocates more of its net worth 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 apportion its net worth 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.

The Secretary must issue a written decision on a corporation's request for an alternative apportionment method. The decision can apply to no more than three years. A corporation may renew a request to use an alternative apportionment method by following the same procedure. 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 net worth base using the alternative method or the statutory method.

Note: A \$5,000 fee is required to request a written determination for an alternative apportionment ruling. For more information, please see the written determination policy and Form NC-481 Request for Written Determination on the Department's website at:

<https://www.ncdor.gov/written-determinations-and-letters-general-applicability>

## **F. Corporate Members of LLCs (G.S. § 105-114.1)**

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

If a corporation or affiliated group of corporations owns, directly or constructively, more than fifty percent (50%) 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 net worth base.

Exception – if the total book value of the LLC's assets never exceeds one hundred fifty thousand dollars (\$150,000) during its tax 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 base(s). 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 base(s) 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 an 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.
- 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) 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 base(s) is determined as follows:

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

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 computation may exclude its investment in the LLC from its computation of the net worth base.

Shifting assets back and forth between a corporation and an LLC to avoid franchise tax is prohibited. Ownership of the capital interests in an LLC is determined as of the last day of the LLC's tax 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 tax year, the ownership of the capital interest in the LLC must be determined as of the last day of the corporation's tax 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\(a\)\(7\)](#). For additional information on the filing requirements for members of LLCs, see Item 5, Subsection H "Corporations Conditionally or Partially Exempt."

## **G. 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 joint 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, 2019, through July 31, 2019 (seven (7) months). Franchise tax paid on the 2018 return applicable to the calendar year 2019 was \$240. Franchise tax on the short period would be applicable to the year August 1, 2019, through July 31, 2020, and would be computed as follows:

Total tax due per return	\$268
Less credit for portion of prior year's tax:	
Total tax paid on 2018 return	\$240
Less amount applicable to short period (7/12 of \$240)	<u>140</u>
Amount applicable beyond short period	100
Net franchise tax due on short period return	\$168

### **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, 2018. ABC filed a combination franchise and income tax return for the year ended July 31, 2018, and paid franchise tax of six hundred dollars (\$600) applicable to the ensuing year ending July 31, 2019. XYZ filed a combination franchise and income tax return for the calendar year 2018 and paid franchise tax of seven hundred dollars (\$700) applicable to the ensuing calendar year 2019. 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, 2018. The year to which ABC's payment applied overlapped the year to which XYZ's payment applied by seven months (January 1, 2019, through July 31, 2019) 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

## **H. Corporations Conditionally or Partially Exempt (G.S. §§ 105-122, 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, the membership of which is limited to the owners or occupants of residential units in the condominium, housing development, or cooperative housing corporation.
- 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 tax.

## **3. Regulated Investment Companies (RIC) and Real Estate Investment Trusts (REIT)**

These organizations are required to pay franchise tax; however, in determining net worth 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. Captive REITs are not allowed this deduction. A captive REIT is a REIT whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are owned or controlled, at any time during the last half of the tax year, by a person that is subject to tax under this Part and is not a trust or another entity that qualifies as a real estate investment trust under section 856 of the Code or a listed Australian property.

## **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 57D of the North Carolina General Statutes) permits the organization and operation of limited liability companies. (LLCs). An LLC is a creation of state law, and the laws governing LLCs vary in each state. An LLC is a business structure that can combine the pass-through taxation of a partnership or sole proprietorship with the limited liability of a corporation. By default, an LLC is not a corporation under North Carolina franchise tax statutes and is not subject to the franchise tax, unless the LLC elects to be taxed as a corporation under the Code. In such case, the LLC would be subject to the North Carolina franchise tax.

## II. CORPORATE INCOME TAX (Article 4 – Part 1)

### A. **Corporations Subject to Tax, Tax Rate and Allocation Requirements** (G.S. §§ [105-130.3](#), [105-130.4](#))

#### 1. Preliminary Statement on Taxed S Corporations

*Session Law 2021-180* added new section G.S. § 105-131.1A to allow eligible S corporations to elect to pay the North Carolina income taxes at the entity level (a “Taxed S Corporation”). For information regarding Taxed S Corporations, see the section on Taxed Pass-Through Entities in the [Personal Taxes Bulletin](#). **Important:** For purposes of this section, an “S corporation” is *NOT* a “Taxed S Corporation.”

#### 2. Domestic and Foreign Corporations Required to File ([17 NCAC 05C.0101](#))

All domestic corporations (those organized in North Carolina), and all foreign corporations (those organized outside North Carolina) with a certificate of authority to do business or doing business in North Carolina, are subject to income tax and are required to file annual income tax returns, except corporations excluded under the disaster relief provisions or those specifically exempt from the tax under G.S. § [105-130.11](#), and S corporations exempt under G.S. § [105-131.1](#).

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 even if it is not 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, isolated job in North Carolina to be completed within six months, may not be required to obtain a certificate of authority to do business in this State under the Business Corporation Act but would be subject to income tax.

Effective August 1, 2019, a nonresident business is not subject to corporate income tax if the nonresident business derives income in North Carolina solely from performing disaster-related work during a disaster response period at the request of a critical infrastructure company. See [Appendix A](#) for more information on the disaster relief provisions provided in G.S. § 166A-19.70A, including applicable definitions, limitations, and notifications required to qualify for the tax and filing exclusion.

Note: A corporation organized in North Carolina or with a certificate of authority to do business in North Carolina must file an income tax return as a matter of record, even if the corporation was inactive or did not earn any net income in the tax year.

### **3. “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; or
- 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” in the State.

“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.

### **4. 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 as outlined above 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 to file

income tax returns under the Department's current policy. However, if such a corporation maintains an office or other place of business in North Carolina, owns business property in this State, or meets the doing business definition, it is subject to the tax.

Note: Corporations that qualify for the income tax exclusion under the disaster relief provisions in G.S. § 166A-19.70A are not subject to income tax and are not required to file a corporate income tax return. See [Appendix A](#) for more information on the disaster relief provisions provided in G.S. § 166A-19.70A, including applicable definitions, limitations, and notifications required to qualify for the tax and filing exclusion.

## **5. Tax Rate and Basis for the Tax (G.S. §§ [105-130.3](#), [105-130.4](#))**

An income tax is levied on the State net income of all corporations chartered or doing business in North Carolina unless they are specifically exempt from tax under G.S. §§ [105-130.11](#) and [105-131.1](#). State net income is taxable income as defined in the 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](#).

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](#).

For tax years beginning on or after January 1, 2019, but before 2025, the corporate income tax rate is 2.5%.

Beginning in tax year 2025, corporate income tax will be phased out. Below are the applicable tax rates:

<u>Tax Years Beginning</u>	<u>Tax Rate</u>
In 2025	2.25%
In 2026	2%
In 2028	1%
After 2029	0%

For a list of prior year tax rates, please visit the Department's website at:

<https://www.ncdor.gov/taxes/corporate-income-franchise-tax/tax-rate-and-basis-tax>

## **6. Corporations Required to Allocate and Apportion Income (G.S. § [105-130.4](#), [17 NCAC 05C .0601](#) and [.0701](#))**

A corporation must have business income from North Carolina and at least one other state to apportion and allocate its income. When a corporation is only taxable in another state as a result of nonapportionable income, then all apportionable income is attributed to North Carolina.

A corporation taxable both within and without North Carolina is required to use the allocation and apportionment provisions of G.S. § [105-130.4](#) to calculate 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 based on North Carolina standards for doing business in this State, except as limited by 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.

## **7. 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 Voluntary Disclosure Program, N.C. Department of Revenue, P.O. Box 871, Raleigh, N.C. 27602-0871.

## **8. Tax Forms**

Corporation tax returns, Form CD-405 or Form CD-401S, are available from the Department's website at:

<https://www.ncdor.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

## **B. Tax Credits**

Taxpayers are allowed various tax credits in Chapter 105 of the General Statutes that could be used to reduce corporate income tax. The following is a list of income tax credits that were repealed or are scheduled to expire, but are still eligible for carryforwards:

**The credits below expired for tax years beginning on or after January 1, 2015:**

- Credit for Rehabilitating Income-Producing Historic Structure - G.S. § [105-129.35](#)
- Credit for Rehabilitating Non-Income-Producing Historic Structure - G.S. § [105-129.36](#)

**The credits below expired for tax years beginning on or after January 1, 2016:**

- Credit for Investing in Renewable Energy Property - G.S. § [105-129.16A](#)
- North Carolina Research & Development - G.S. § [105-129.55](#)

**The credits below expired for tax years beginning on or after January 1, 2018:**

- Credit for Manufacturing Cigarettes for Exportation - G.S. § [105-130.45](#)
- Credit for Manufacturing Cigarettes for Exportation While Increasing Employment and Utilizing State Ports - G.S. § [105-130.46](#)

**The credit below will expire for tax years beginning on or after January 1, 2027:**

- Credit for Certain Real Property Donations (NC Conservation Tax Credit) - G.S. § 105-130.34A

**The credits below will expire for tax years beginning on or after January 1, 2030:**

- Credit for Rehabilitated Mill Property (General/Non-Railroad Station) - G.S. § [105-129.71](#)
- Credit for Income-Producing Rehabilitated Mill Property (Railroad Station) - G.S. § [105-129.71\(a1\)](#)
- Credit for Non-Income-Producing Rehabilitated Mill Property - G.S. § [105-129.72](#)

**The credit below will expire for tax years beginning on or after January 1, 2038:**

- Credit for Constructing a Railroad Intermodal Facility - G.S. § [105-129.96](#)

For more specific information on tax credits, please see **Section IX - [Tax Credits](#)** of this Bulletin.

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

### **1. Preliminary Statement**

A corporation uses its federal taxable income, as defined in the Code in effect for the tax year for which the return is to be filed, as its beginning point and adds or deducts the items listed below to compute State net income or loss.

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 are included in determining State net income or loss in the year of disposition.
- f. Any amount allowed as a 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 any intercompany transaction.
- 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, available at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

- 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. A taxpayer making this election does not relieve the recipient from filing a North Carolina income tax return or apportioning royalty income pursuant to G.S. § [105-130.4](#).

For purposes of G.S. § [105-130.7A](#), 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 to a related recipient if the related recipient is organized under the laws of another country, that country has a comprehensive income tax treaty with the United States, and that country imposes a tax on the royalty income of the recipient at a rate that is equal to or exceeds the State's corporate income tax rate.

1. 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 dividends paid deduction allowed to a captive Real Estate Investment Trust (“REIT”). 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 North Carolina corporate income tax. REITs owned by other REITs or listed Australian property trusts are excluded from the definition.
- n. The amount allowed as a deduction under section 163(e)(5)(F) of the Code for an original issue discount on an applicable high yield discount obligation.
- o. The amount required to be added under G.S. § [105-130.5B](#) when the State decouples from federal accelerated depreciation and expensing. *See section 4, Adjustments When State Decouples from Bonus Depreciation and Section 179 Expenses.*
- p. The amount of net interest expense as determined under G.S. § [105-130.7B](#).
- q. The amount of gain excluded under section 1400Z-2 of the Code because the gain was reinvested into a qualified Opportunity Fund as defined under the Code. This adjustment does not result in a difference in basis of the affected assets for State and federal income tax purposes.
- r. The amount of gain excluded under section 1400Z-2 of the Code because the gain was accrued from the sale or exchange of an investment in an Opportunity Fund held for at least ten (10) years.
- s. The amount associated with foreign derived intangible income (FDII) and global intangible low-taxed income (GILTI) allowed as a deduction under section 250 of the Code.
- t. The amount allowed as a deduction associated with section 965(c) repatriation income of the Code.

- u. The amount of payments made to an affiliate or subsidiary that is not subject to corporate income tax pursuant to the exceptions for critical infrastructure disaster relief provided under G.S. § 166A-19.70A to the extent the payments are deducted in determining federal taxable income.
- v. For tax years 2019 and 2020, the amount equal to the amount that the taxpayer's interest expense deduction under section 163(j) of the Code (as calculated on a separate entity basis) exceeded the interest expense deduction that would have been allowed under the Code as of January 1, 2020. This addition is not required if the amount is already added to the taxpayer's federal taxable income under another provision of North Carolina corporate income tax law.
- w. For tax years beginning on or after January 1, 2023, a taxpayer must add back the amount of any expense deducted under the Code to the extent the expense is allocable to income that is either wholly excluded from gross income or wholly exempt from income tax.

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

- a. Interest from obligations of the United States or its possessions, net of related expenses, to the extent included in federal taxable income. However, interest on obligations of the United States shall not be an allowable deduction unless interest from obligations of the State of North Carolina or any of its political subdivisions is exempt from income tax imposed by the United States.
- 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, a nonprofit educational institution organized or chartered under the laws of this State, and a hospital authority created under G.S. § [131E-17](#), to the extent the amounts are included in federal taxable income.
- c. Payments received from a parent, subsidiary, or affiliated corporation in excess of fair compensation in intercompany transactions which were not allowed as a deduction for North Carolina income tax purposes by such corporation(s).
- 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 is calculated in accordance with G.S. §§ [105-130.5\(c\)\(3\)](#) and [105-130.6A](#).
- e. Any amount included in federal taxable income under sections 78, 951, 951A, or 965 of the Code, net of related expenses.
- f. For tax years beginning on or after January 1, 2015, state net losses are calculated under the provisions of G.S. § [105-130.8A](#). For specific instructions with respect to net

economic loss and state net loss determinations *see Subject: "State Net Loss Deduction and 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. The amount of losses realized on the sale or other disposition of assets not allowed under section 1211(a) of the Internal Revenue Code. All losses recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.
- i. 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.
- j. If a deduction for an ordinary and necessary business expense was required to be reduced or was not allowed under the Code because the corporation claimed a federal tax credit against its federal income tax liability for the income year in lieu of a deduction, the amount by which the deduction was reduced and the amount of the deduction that was disallowed.
- k. For tax years beginning on or after January 1, 2022, the amount by which the deduction for ordinary and necessary business expenses were required to be reduced or were not allowed under the Code because the taxpayer claimed a federal employee retention tax credit against employment instead of a deduction. This deduction is allowed only to the extent that a similar credit is not allowed for the same amount.
- l. The amount by which the basis of a depreciable asset has been reduced on account of a tax credit allowed for federal tax purposes or a Section 1603 grant.
- m. The amount of natural gas expansion surcharges collected by a natural gas local distribution company under G.S. § [62-158](#).
- n. To the extent included in federal taxable income, the amount of 911 charges imposed under G.S. § [143B-1403](#) and remitted to the 911 Fund under that section.
- o. 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. For purposes of G.S. § [105-130.7A](#), intangible property is defined as copyrights, patents, and trademarks.
- p. 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.

- q. The amount allowed as a deduction under G.S. § [105-130.5B](#) resulting from the add-back of federal income tax accelerated depreciation or expensing of assets. *See subsection C, item 4, “Adjustments When State Decouples from Bonus Depreciation and Expensing.”*
- r. The amount of qualified interest expense to a related member as determined under G.S. § [105-130.7B](#).
- s. The amount paid during the tax year from the State Emergency Response and Disaster Relief Reserve Fund for hurricane relief or assistance to the extent included in federal taxable income. No deduction is allowed for payments received by the taxpayer for goods and services provided by the taxpayer.
- t. The amount of gain included in federal taxable income under section 1400Z-2(a) of the Code to the extent the same income was included in North Carolina taxable income in a prior year.
- u. The amount received as an economic incentive under the Job Maintenance and Capital Development Fund (JMAC), the Jobs Development Investment Grant Program (JDIG), or the One North Carolina Fund.
- v. For tax years beginning on or after January 1, 2020 and to the extent it is included in federal taxable income, the amount received under the Business Recovery Grant Program, the ReTOOLNC grant program for recovery from the economic impacts of the COVID-19 pandemic, or rent and utility assistance pursuant to Section 3.3 of S.L. 2020-4, as amended by Section 1.2 of S.L. 2020-97 and Section 18.(a) of S.L. 2023-46.
- w. Twenty percent (20%) of the amount added to federal taxable income under G.S. § 105-130.5(a)(31), that was not otherwise disallowed by G.S. § 105-130.7B, in each of the first five tax years beginning with tax year 2021.

***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 prior to January 1, 1967.

- 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 \(b\)](#). *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. 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.

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

A corporation that withdraws, 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 one hundred five (105) 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.

### **4. Adjustments When State Decouples from Bonus Depreciation and Section 179 Expensing (G.S. § [105-130.5B](#))**

#### **a. General**

North Carolina law differs from the Code with respect to bonus depreciation under sections 168(k) and (n). In addition, adjustments may be required for amounts deducted under section 179 of the Code. For tax years beginning on or after January 1, 2013, taxpayers are required to make a bonus asset basis adjustment if an asset is transferred, and the tax basis of the asset carries over from the transferor to the transferee for federal income tax purposes.

#### **b. Bonus Depreciation Deduction (G.S. § [105-130.5B\(a\)](#))**

Taxpayers cannot deduct the full amount of bonus depreciation deduction for federal income tax purposes in the year allowed under sections 168(k) and (n). Instead, taxpayers are required to add back eighty-five percent (85%) of the federal bonus depreciation in the year taken for federal income tax. Taxpayers may deduct 20% of the total amount of bonus depreciation added to federal taxable income in each of the first five tax years following the year the taxpayer is required to include the add-back into income. Thus, the federal bonus depreciation deduction is spread over six tax years for North Carolina income tax purposes.

The adjustments do not result in a basis difference for federal and State income tax purposes, except as discussed in *Section d*, below.

**c. Section 179 Expenses (G.S. § [105-130.5B\(c\)](#))**

North Carolina does not conform to the same Code section 179 expensing limitations allowed for federal income tax purposes. Instead, North Carolina has separate dollar and investment limitations.

Since tax year 2013, the NC Dollar Limitation is \$25,000 and the NC Investment Limitation is \$200,000.

Taxpayers placing section 179 property into service are required to add to federal taxable income 85% of the section 179 deduction in excess of the amount allowed using the North Carolina limit. Taxpayers may subsequently deduct 20% of the amount of bonus depreciation added to taxable income in each of the first five tax years following the year the taxpayer is required to include the add-back into income. The adjustments do not result in a basis difference for federal and State income tax purposes, except as discussed in *Section d*, below.

**d. Bonus Asset Basis Adjustments**

A bonus asset basis adjustment is required when the following occurs:

- i. There is an actual or deemed transfer of an asset occurring on or after January 1, 2013; and
- ii. The tax basis of the transferred asset carries over from the transferor to the transferee (i.e., the taxpayer) for federal income tax purposes.

To make an asset basis adjustment, a taxpayer must add any remaining bonus depreciation deductions associated with the transferred asset to the basis of the transferred asset and depreciate the adjusted basis over the remaining life of the asset. The remaining life of the asset is the remaining years in the asset's federal recovery period, as determined under section 168(c) of the Code.

In addition, upon disposition of the asset, adjusted gross income must be increased or decreased to account for any differences in the basis for State and federal income tax purposes.

For examples and additional information of bonus asset basis adjustments, please refer to the **Personal Taxes Bulletin, Section XX**, "Bonus Asset Basis" at:

<https://www.ncdot.gov/taxes-forms/partnership-tax/personal-taxes-bulletins>

**D. Interest Income on Government Obligations (G.S. §§ [105-130.3](#), [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. For examples of North Carolina obligations exempt from corporate income tax on interest income and gains, see:

<https://www.ncdor.gov/income-north-carolina-obligations>

**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 as 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.

For detailed information on U.S. obligations exempt from tax, see:

<https://www.ncdor.gov/interest-income-us-obligations>

**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.

For examples of North Carolina obligations exempt from corporate income tax on interest income and gains, see:

<https://www.ncdor.gov/income-north-carolina-obligations>

## 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](#), [105-130.5](#), [17 NCAC 05C.0304](#))

### 1. Direct Expenses

All expenses directly connected with the production of income 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 a 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 not taxed, including dividends excluded by section 243 of the Code and dividends classified as nonapportionable (G.S. §§ [105-130.4](#), [105-130.5\(c\)\(3\)](#))
- Interest income classified as nonapportionable (G.S. § [105-130.4](#))
- Interest income earned on obligations of the United States and the State of North Carolina
- 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 tax 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. Dividends ([G.S. §§ 105-130.5\(b\)\(3a\) and \(c\)\(3\)](#))**

For tax years beginning on or after January 1, 2016, expenses attributed to dividends not taxed for North Carolina income tax purposes cannot exceed 15%.

## **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 methodologies set forth in the 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 in *Item 2* above may be used to determine the amount of supportive function expenses attributable to untaxed income. In determining “supportive function expenses,” direct expenses incurred exclusively in a specific identifiable taxable or nontaxable activity should be excluded before applying 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 removed from the two ratios when computing the attribution percentage.

## **F. Related Entity Interest Deduction Limitation (G.S. § 105-130.7B)**

### **1. Preliminary Statement**

For tax years beginning on or after January 1, 2016, a corporation may only deduct the amount of qualified interest expense from a related member, as defined in G.S. § 105-130.7A, unless an exception applies.

### **2. Qualified Interest Expense**

A deduction is allowed for qualified interest expense paid or accrued by the taxpayer to a related member during a taxable year. Qualified interest expense is the amount of net interest expense paid or accrued to a related member in a taxable year with the amount limited to the taxpayer's proportionate share of interest paid or accrued to a person who is not a related member during the same taxable year. This limitation does not apply to the proportionate share of interest paid or accrued to a related member that is the ultimate payee if one or more of the exceptions apply (*see item #3 “Exceptions” below*).

Net interest expense is the excess of the interest paid or accrued by the taxpayer to each related member during the taxable year over the amount of interest from each related member includible in the gross income of the taxpayer for the taxable year.

A taxpayer's proportionate share of interest is:

- a. The amount paid or accrued directly to or through a related member to an ultimate payer, divided by...
- b. The total net interest expense of all related members paid or accrued directly through a related member to the same ultimate payer, multiplied by...

c. The interest amount paid or accrued by the ultimate payer to an unrelated party. Amounts distributed, paid, or accrued through a related member that is not treated as interest for North Carolina income tax purposes does not qualify.

The ultimate payer is the related member that receives or accrues interest directly or indirectly from other related members and pays or accrues interest to an unrelated entity. The ultimate payee is a related member that receives or accrues interest directly from a related member or indirectly through related members.

### **3. Exceptions**

- a. An income tax is imposed by North Carolina on the amount of interest income received by the related member;
- b. An income or gross receipts tax is imposed by another state on the related member with respect to the interest income;
- c. The related member is an entity organized under the laws of a foreign country that has a comprehensive tax treaty with the United States and taxes the interest income at a rate equal to or greater than provided under G.S. § [105-130.3](#);
- d. The related member is a bank. For the purposes of this section, a bank includes a bank holding company as defined in the Bank Holding Company Act of 1956; a bank, savings bank, savings and loan association, or trust company, as each is defined in G.S. §§ 53C, 54B, and 54C; or a subsidiary or affiliate of any of these entities; or
- e. The proportionate amount of interest paid or accrued to a related member that has already been disallowed by the application of section 163(j) of the Code.

## **G. 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. Alternative Apportionment Formula ([17 NCAC 05D.0107-0115](#))**

If a C corporation, S corporation, or limited liability company electing to be taxed as either a C or S corporation for federal income tax purposes, believes that the statutory apportionment

formula subjects 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 alternate apportionment formula. The request must set out the reasons for the corporation's belief and propose an alternative method. The corporation has the burden of proof for demonstrating why the statutory method subjects it to taxation on a greater proportion of income than is reasonably attributable to North Carolina.

Note: A \$5,000 fee is required to request a written determination for an alternative apportionment ruling. For more information, please see the written determination policy and Form NC-481 Request for Written Determination on the Department's website at:

<https://www.ncdot.gov/written-determinations-and-letters-general-applicability>

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, Department of Revenue, PO Box 871, Raleigh, NC 27602-0871. The Secretary will schedule a conference to hear the corporation's request. The Secretary and the Director of the Corporate Tax Division and/or their designee(s) will attend the conference. The taxpayer is not required to appear or be represented at the conference; however, an authorized representative may appear on behalf of, or in addition to, the taxpayer.

The Secretary must issue a written decision on a corporation's request for an alternative apportionment method within sixty (60) days from the date of the conference or sixty (60) days after the date any requested additional information is provided. The decision can apply to no more than three years. A corporation may renew a request to use an alternative apportionment method by reapplying to the Secretary of Revenue. A corporation authorized to use an alternative formula may apportion its Net Worth base using the alternative method or the statutory method.

If the Secretary finds the statutory method does not fairly represent the corporation's activities in the State, remedies include requiring separate accounting, inclusion or exclusion of one or more factors, or any other method that results in equitable apportionment and allocation of income. If the request is for both income and franchise tax, a separate determination will be made for each tax.

If the request is denied, the Secretary's decision is final and is not subject to administrative or judicial review. A corporation may not use an alternative apportionment method except upon written order by the Secretary, and any return filed using a method other than the statutory method without the Secretary's permission is not a lawful return.

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

#### **a. Determine North Carolina Taxable Income**

A corporation must determine its State 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 Step *h*.

**b. Determine Nonapportionable Income**

A corporation must review its entire net income or loss as computed in Step *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.”*

**c. Determine Apportionable Income**

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

**d. Compute Apportionment Factors**

A 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. Income Apportioned to North Carolina**

A corporation determines the amount of its apportionable income or loss attributable to North Carolina by applying the factor computed in Step *d* to apportionable income or loss as computed in Step *c*.

**f. Determine Nonapportionable Income Allocated to North Carolina**

A corporation should review the total amount of nonapportionable income or loss as computed in Step *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 Step *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 State Net Loss Deduction**

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

**h. Determine Income before Contributions to North Carolina Donees**

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

**i. Determine Net Taxable Income**

Finally, a 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 Step h.

**H. Taxable in Another State (G.S. § [105-130.4](#))**

**1. Preliminary Statement ([17 NCAC 05C.0601](#))**

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 ([17 NCAC 05C.0602](#))**

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**

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

- a. 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.
- b. 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 Corporation is “Subject To” Tax ([17 NCAC 05C.0604](#))**

- 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 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 ([17 NCAC 05C.0605](#))**

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.

## **I. [Apportionable and Nonapportionable Income \(G.S. § 105-130.4\)](#)**

### **1. [Division of Income – In General \(\[17 NCAC 05C.0701\]\(#\)\)](#)**

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 those subject to special apportionment, is divided between the jurisdictions in which the business is conducted pursuant to the sales apportionment factor set forth in G.S. § 105-130.4(l). 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 factor 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 (G.S. § [105.130.4](#))**

"Apportionable income" is defined as all income that is apportionable under the United States Constitution. For purposes of administration of G.S. § [105-130.4](#), all income of a taxpayer is apportionable income unless clearly classifiable as nonapportionable income under the law and 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 ([17 NCAC 05C.0704](#))**

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."*

## **J. [Apportionment Factors \(G.S. §§ 105-130.4, 105-130.4\(i\)\)](#)**

### **1. General Business Corporations**

Corporations engaged in multistate business activity, except for those subject to special apportionment, are required to apportion to this State all apportionable income using the sales factor.

Corporations subject to special apportionment are discussed in the following *item #2, “[Special Apportionment](#).”*

Although wholesale content distributors and banks use the sales factor for apportionment, they are subject to special rules and definitions. For more information on the apportionment factor for a wholesale content distributor or bank, *see item #3, “[Wholesale Content Distributor Apportionment Factor](#)”, and item #4, “[Bank Apportionment Factor](#).”*

For information on the apportionment rules for a corporate taxpayer with a State net loss balance at the end of its 2019 tax year, *see item #5, “[State Net Loss Apportionment Election](#).”* Other corporate taxpayers may request alternative apportionment by submitting the required fee and Form NC-481, “Request for Written Determination”, which is located on the Department’s website at the link below:

<https://www.ncdot.gov/documents/nc-481-request-written-determination>

**a. Sales Factor (G.S. § [105-130.4](#))**

**i. Sales Factor – Sales Made in General Business Operations ([17 NCAC 05C.1001](#))**

G.S. § [105-130.4\(a\)\(7\)](#) defines “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 represent a return of principal. Sales also excludes the portion of receipts from financial swaps and other similar financial derivatives representing the notional principal amount that generates cash flow traded in the swap agreement, and dividends subtracted under G.S. § [105-130.5](#)(b)(3a) and (3b), and dividends excluded from federal tax.

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 G.S. § [105-130.4\(a\)\(1\)](#).

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 tax year) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts 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 ([17 NCAC 05C.1002](#))**

As a general rule, “sales” 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 ([17 NCAC 05C.1003](#))**

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 including prepaid amounts for these services.

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 property, such as patents and copyrights, “sales” includes the gross receipts therefrom.

**iv. Sales Factor – What Sales of Tangible Personal Property Are In This State (17  
NCAC 05C.1005)**

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 1:* 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 2:* 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 3:* 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 4:* 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.

**v. Sales Factor – Sales to United States Government ([17 NCAC 05C.1006](#))**

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.

**vi. Sales Factor – Numerator ([17 NCAC 05C.1004](#), G.S. § [105-130.4\(l\)](#))**

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.

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

G.S. § 105-130.4(l) contains provisions for including gross receipts from other business income transactions in the numerator of the sales factor.

**1. Market-Based Sourcing of Receipts ([G.S. § 105-130.4\(l\)](#))**

Receipts are in this State if the taxpayer's market for the receipts is in this State. If the market for a receipt cannot be determined, the state or states of assignment shall be reasonably approximated. In a case in which a taxpayer cannot ascertain the state or

states to which receipts of a sale are to be assigned through the use of a method of reasonable approximation, the receipts must be excluded from the denominator of a taxpayer's sales factor.

Except as otherwise provided by this section, a taxpayer's market for receipts is in this State as provided below:

- a. If the receipts are from the sale, rental, lease, or license of real property, if and to the extent the property is located in this State.
- b. If the receipts are from the rental, lease, or license of tangible personal property, if and to the extent the property is located in this State.
- c. If the receipts are from the sale of tangible personal property, if and to the extent the property is received in this State by the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed is considered the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State constitutes delivery to the purchaser in this State.
- d. If the receipts are from the sale of a service, if and to the extent the service is delivered to a location in this State.
- e. If the receipts are from intangible property that is rented, leased, or licensed, if and to the extent the property is used in this State. Intangible property utilized in marketing a good or service to a consumer is "used in this State" if that good or service is purchased by a consumer who is in this State.
- f. If the receipts are from intangible property that is sold, if and to the extent the property is used in this State. A contract right, government license, or similar intangible property that authorized the holder to conduct a business activity in a specific geographic area is "used in this State" if the geographic area includes all or part of this State. Receipts from a sale of intangible property that is contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease, or licensing of the intangible property as provided under item (e) above. All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the sales factor.

Receipts of general interest income not addressed elsewhere in the document shall be sourced by use of a method consistent with the established principles of market-based sourcing. However, in the course of a taxpayer's regular business, interest income can be earned from transactions other than the sale, rental, lease, or licensing of real property, tangible personal property, or intangible property. In those instances, it may be difficult

to determine how to source interest income under the market-based sourcing methodology. The following examples provide some guidance for those taxpayers that have interest income that cannot be sourced under rules provided elsewhere in this document. For the rules that apply to interest income received by a Bank, *see Section J, 4.*

**Examples (Interest Income for Non-Bank Entities):**

*Example 1:* Parent Corp and Subsidiary A (Sub A) are based outside North Carolina and do not meet the definition of a bank. Both Parent Corp and Sub A are doing business in North Carolina. Parent Corp issues an interest-bearing loan to Sub A. Assume that the loan agreement states that Sub A must use funds from the loan to acquire and develop property in North Carolina. The receipts from interest on the loan would be sourced to North Carolina since the loan proceeds are used for income-producing business activities in North Carolina.

*Example 2:* Same facts as Example 1, except that the loan agreement does not state what funds from the loan must be used for. Parent Corp must attempt to reasonably approximate the extent to which funds from the loan are used in or may be used in North Carolina. For purposes of making this reasonable approximation, Parent Corp may rely upon gross revenues from Sub A's property in North Carolina. The receipts from interest on the loan would be sourced to North Carolina to the extent that the loan proceeds are used for income-producing business activities in North Carolina.

*Example 3:* Same facts as Example 2, except that the loan agreement does not state what the funds from the loan must be used for and neither Parent Corp, nor the Department of Revenue, have a method by which to reasonably approximate the extent to which the receipts should be sourced to North Carolina. In this case, the receipts would be excluded from the sales factor.

**2. Definitions ([17 NCAC 05G .0102](#))**

Definitions applying to the rules for market-based sourcing are found in [17 NCAC 05G .0102](#).

**3. Assignment of Receipts – Sales Other Than of Tangible Personal Property ([17 NCAC 05G .0201](#))**

A taxpayer's assignment of receipts for sales other than those of tangible personal property are discussed in [17 NCAC 05G .0201](#).

#### **4. Rules of Reasonable Approximation**

##### **a. In General ([17 NCAC 05G .0301](#))**

The rules of reasonable approximation set forth the process that applies if the state or states of assignment cannot be determined. In some cases, the reasonable approximation will be made in accordance with specific rules of approximation.

In other cases, the applicable rules will permit a taxpayer to reasonably approximate the state or states of assignment to obtain a result similar to those made using a specific rule of approximation.

##### **b. Approximation Based Upon Known Sales ([17 NCAC 05G .0302](#))**

Approximating the assignment of receipts based upon known sales is discussed in 17 NCAC 05G .0302.

##### **c. Related Entity Transactions ([17 NCAC 05G .0303](#))**

If a taxpayer has receipts from transactions with a related entity customer, information that the customer has regarding the sourcing of receipts from those transactions shall be imputed to the taxpayer.

#### **5. Exclusion of Receipts from the Sales Factor**

##### **a. Allocated Gross Receipts ([17 NCAC 05G .0401](#))**

The sales factor includes only gross receipts of the taxpayer that are not allocated under G.S. § 105-130.4, and are received from transactions and activity in the regular course of the taxpayer's trade or business.

See 17 NCAC 05G .0401 for more information on gross receipts allocated or excluded from the sales factor.

##### **b. Unassignable Gross Receipts ([17 NCAC 05G .0402](#))**

If a taxpayer is unable to determine the state or states where receipts of a sale should be assigned pursuant to the rules provided in 17 NCAC 05G using a reasonable amount of effort undertaken in good faith, the receipts shall be excluded from the denominator of the taxpayer's sales factor.

#### **6. Changes in Methodology**

##### **a. Alternative Apportionment ([17 NCAC 05G .0501](#))**

If the application of the rules in 17 NCAC 05G results in the assignment of receipts to the taxpayer's sales factor that the taxpayer believes does not fairly represent the extent of the taxpayer's business activity in North Carolina, the

taxpayer may request the use of a different method for assigning those receipts under G.S. § 105-122(c1)(2) or G.S. §105-130.4(t1).

**b. Original Returns ([17 NCAC 05G .0502](#))**

The assignment of receipts on original returns filed is discussed in 17 NCAC 05G .0502.

**c. Secretary's Authority to Adjust a Taxpayer's Return ([17 NCAC 05G .0503](#))**

The Secretary's ability to review and adjust a taxpayer's assignment of receipts on a return is discussed in 17 NCAC 05G .0503.

**d. Taxpayer's Authority to Change a Method of Assignment on a Prospective Basis ([17 NCAC 05G .0504](#))**

A taxpayer seeking to change its method of assigning its receipts shall disclose, on the original return filed for the year of the change, that they have made the change. If the taxpayer does not disclose the change, the Secretary may disregard the taxpayer's change and substitute a method of assignment that the Secretary determines appropriate.

**e. Secretary Authority to Change a Method of Assignment on a Prospective Basis ([17 NCAC 05G .0505](#))**

The Secretary's authority to change a method of assignment for returns that have not yet been filed is discussed in 17 NCAC 05G .0505.

## 7. Sale of a Service

**a. In General ([17 NCAC 05G.0701](#))**

The receipts from the sale of a service are sourced to North Carolina to the extent that the service is delivered to a location in North Carolina. “Delivered to a location” means the location of the taxpayer’s market for the service, which may not be the location of the taxpayer’s employees or property.

**b. Sale of In-Person Services ([17 NCAC 05G .0801](#))**

“In-person services” are services that are physically provided in person by the taxpayer, where the customer or the customer’s real or tangible property on which the services are performed is in the same location as the service provider at the time the services are performed. For more information on in-person services, see [17 NCAC 05G .0801](#).

The assignment of receipts from the sale of in-person services are discussed in [17 NCAC 05G .0802](#). Receipts from in-person services performed on the body of a

person, in the physical presence of a customer, on real estate, or on non-shipped tangible personal property are sourced to North Carolina if the customer is located in North Carolina. Receipts from shipped tangible personal property are sourced to North Carolina if the property is shipped or delivered to a customer located in North Carolina.

If the taxpayer cannot determine the state or states where a service was received, but the taxpayer has information regarding the location of receipt that the taxpayer can use to reasonably approximate the state or states where the service is received, the taxpayer shall reasonably approximate such state or states according to [17 NCAC 05G .0803](#).

**Examples (Sale of In-Person Services):**

For purposes of the following examples, it is irrelevant whether the services are performed by an employee of the taxpayer or by an independent contractor acting on the taxpayer's behalf.

*Example 1:* Salon Corp has retail locations in North Carolina and in other states where it provides hair cutting services to individual and business customers, the latter of whom are paid for by the means of a company account. The receipts from sales of services provided at Salon Corp's North Carolina locations are North Carolina sales. The receipts from sales of services provided at Salon Corp's locations outside North Carolina, even when provided to residents of North Carolina, are not North Carolina sales. See [17 NCAC 05G .0802](#).

*Example 2:* Landscape Corp provides landscaping and gardening services in North Carolina and in neighboring states. Landscape Corp provides landscaping services at the North Carolina vacation home of an individual who is a resident of another state and who is located outside North Carolina at the time the services are performed. The receipts from the sale of services provided at the North Carolina location are North Carolina sales. See [17 NCAC 05G .0802](#).

*Example 3:* Same facts as in Example 2, except that Landscape Corp provides the landscaping services to Retail Corp, a corporation with retail locations in several states, and the services are with respect to those locations of Retail Corp that are in North Carolina and in other states. The receipts from the sale of services provided to Retail Corp are in North Carolina to the extent the services are provided in North Carolina. See [17 NCAC 05G .0802](#).

*Example 4:* Camera Corp provides camera repair services at a North Carolina retail location to walk-in individual and business customers. In some cases, Camera Corp actually repairs the camera at a facility that is in another state. In these cases, the repaired camera is then returned to the customer at Camera Corp's in-state location. The receipts from sale of these services are in North Carolina. See [17 NCAC 05G .0802](#).

*Example 5:* Same facts as in Example 4, except that a customer located in North Carolina mails the camera directly to the out-of-state facility owned by Camera Corp to be fixed and receives the repaired camera back in North Carolina by mail. The receipts from sale of the service are in North Carolina. *See [17 NCAC 05G .0802](#).*

*Example 6:* Teaching Corp provides in-person seminars in North Carolina to individual and business customers. The seminars and the materials used in connection with the seminars are prepared outside the state, the teachers who teach the seminars include teachers that reside outside North Carolina, and the students who attend the seminars include students that reside outside North Carolina. Because the seminars are taught in North Carolina, the receipts from sales of the services are in North Carolina. *See [17 NCAC 05G .0802](#).*

**c. Professional Services ([17 NCAC 05G .1001](#))**

“Professional services” are services that require specialized knowledge and may require a professional certification, license, or degree. These services include the performance of technical services that require the application of specialized knowledge.

For more information on what activities are included in professional services, see [17 NCAC 05G .1001](#).

Services that overlap with other categories of services are discussed in [17 NCAC 05G .1002](#).

The assignment of receipts for professional services is discussed in [17 NCAC 05G .1003](#).

Assigning receipts to North Carolina from professional services other than architectural or engineering services is discussed in [17 NCAC 05G .1004](#) and is summarized below:

- **General – individual customer and less than five percent (< 5%) of the taxpayer’s sales of services are from the customer:** If North Carolina is the customer’s state of primary residence; or, if the primary residence is not identifiable, if the customer’s billing address is in North Carolina.
- **General – individual customer and greater than five percent (> 5%) of the taxpayer’s sales of services are from the customer:** If North Carolina is the customer’s primary state of residence. This must be identified.

- **General – business customer and less than five percent (< 5%) of the taxpayer's sales of services are from the customer:** If: (i) the customer principally manages the contract in North Carolina, (ii) if not reasonably determinable, the customer placed the order in North Carolina, (iii) if not reasonably determinable, the customer's billing address is in North Carolina.
- **General – business customer and greater than five percent (> 5%) of the taxpayer's sales of services are from the customer:** If the customer principally manages the contract in North Carolina. This must be determined.
- **General optional safe harbor – individual or business customer (if substantially similar service transactions with greater than 250 customers and less than five percent (< 5%) of the taxpayer's sales of services are from that customer):** If North Carolina is the customer's billing address.

Note: For financial institutions other than banks, receipts are sourced to North Carolina as required under the general professional services rules above.

Assigning receipts to North Carolina for architectural or engineering services with respect to real or tangible personal property is discussed in [17 NCAC 05G .1005](#) and is summarized below:

- **Architectural services – real estate improvements:** If the property is located or expected to be located in North Carolina.
- **Architectural services – other:** As required under the general professional services guidelines.
- **Engineering services – real and tangible personal property:** If the property is located or expected to be located in North Carolina.
- **Engineering services – other:** As required under the general professional services guidelines.

Related entity transactions for professional services are discussed in [17 NCAC 05G .1006](#).

Examples (Professional Services):

Assume in each of these examples, as relevant, that the customer is not a related entity and that the safe harbor rule set forth in [17 NCAC 05G .1004](#) does not apply.

*Example 1:* Broker Corp provides securities brokerage services to individual customers who reside in North Carolina and in other states. Assume that Broker Corp knows the state of primary residence for many of its customers, and when it does not know this state of primary residence, it knows the customer's billing address. Also assume that Broker Corp does not derive more than five percent (5%) of its receipts from sales of all services from any one individual customer. If Broker Corp knows its customer's state of primary residence, it shall source the receipts to that state. If Broker Corp does not know its customer's state of primary residence, but rather knows the customer's billing address, it shall source the receipts to that state. *See [17 NCAC 05G .1004](#).*

*Example 2:* Same facts as in Example 1, except that Broker Corp has several individual customers from whom it derives, in each instance, more than five percent (5%) of its receipts from sales of all services. Receipts from sales to customers from whom Broker Corp derives five percent (5%) or less of its receipts from sales of all services must be sourced as described in Example 1. For each customer from whom it derives more than five percent (5%) of its receipts from sales of all services, Broker Corp is required to determine the customer's state of primary residence and must source the receipts from the services provided to that customer to that state. In any case in which a five percent (5%) customer's state of primary residence is North Carolina, receipts from a sale made to that customer must be sourced to North Carolina; in any case in which a five percent (5%) customer's state of primary residence is not North Carolina, receipts from a sale made to that customer are not sourced to North Carolina. *See [17 NCAC 05G .1004](#).*

*Example 3:* Architecture Corp provides building design services to buildings located, or expected to be located, in North Carolina to individual customers who reside in North Carolina and other states, and to business customers that are based in North Carolina and other states. The receipts from Architecture Corp's sales are sourced to North Carolina because the locations of the buildings to which its design services relate are in North Carolina, or are expected to be in North Carolina. For purposes of sourcing these receipts, it is not relevant where, for an individual customer, the customer primarily resides or is billed for the services, and it is not relevant where, for a business customer, the customer principally manages the contract, placed the order for the services, or is billed for the services. Further, these receipts are sourced to North Carolina even if Architecture Corp's designs are either physically delivered to its customer in paper form in a state other than North Carolina, or are electronically delivered to its customer in a state other than North Carolina. *See [17 NCAC 05G .1002](#) and [.1005](#).*

*Example 4:* Law Corp provides legal services to individual clients who reside in North Carolina and in other states. In some cases, Law Corp may prepare one or more legal documents for its client as a result of these services and/or the legal work may be related to litigation or a legal matter that is ongoing in a state other

than where the client is a resident. Assume that Law Corp knows the state of primary residence for many of its clients, and when it does not know the state of primary residence, it knows the client's billing address. Also assume that Law Corp does not derive more than five percent (5%) of its receipts from sales of all services from any one individual client. If Law Corp knows its client's state of primary residence, it shall source the receipts to that state. If Law Corp does not know its client's state of primary residence, but rather knows the client's billing address, it shall source the receipts to that state. For purposes of the analysis, it is irrelevant whether the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or the litigation or other legal matter that is the underlying predicate for the services is in another state. *See [17 NCAC 05G .1002](#) and [.1004](#).*

*Example 5:* Law Corp provides legal services to several multistate business clients. In each case, Law Corp knows the state in which the agreement for legal services that governs the client relationship is principally managed by the client. In one case, the agreement is principally managed in North Carolina; in the other cases, the agreement is principally managed in a state other than North Carolina. If the agreement for legal services is principally managed by the client in North Carolina, the receipts from sale of the services are sourced to North Carolina; in the other cases, the receipts are not sourced to North Carolina. For receipts that are sourced to North Carolina, the receipts are so sourced even if (1) the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or (2) the litigation or other legal matter that is the underlying predicate for the services is in another state. *See [17 NCAC 05G .1002](#) and [.1004](#).*

*Example 6:* Consulting Corp, a company that provides consulting services to law firms and other customers, is hired by Law Corp in connection with legal representation that Law Corp provides to Client Co. Specifically, Consulting Corp is hired to provide expert testimony at a trial being conducted by Law Corp on behalf of Client Co. Client Co pays for Consulting Corp's services directly. Assuming that Consulting Corp knows that its agreement with Law Corp is principally managed by Law Corp in North Carolina, the receipts from the sale of Consulting Corp's services are sourced to North Carolina. It is not relevant for purposes of the analysis that Client Co is the ultimate beneficiary of Consulting Corp's services, or that Client Co pays for Consulting Corp's services directly. *See [17 NCAC 05G .1004](#).*

*Example 7:* Financial Institution Corp provides payday loan services to 100 individual customers who reside in North Carolina and in other states. Financial Institution Corp is not a bank. Assume for purposes of this example that Financial Institution Corp knows the state of primary residence for many of its customers, and when it does not know the state of primary residence, it knows the customer's billing address. Also assume that Financial Institution Corp does not derive more than five percent (5%) of its receipts from sales of all of its services from any single customer. Note that because Financial Institution Corp does not have more

than 250 customers, it may not apply the safe harbor for professional services stated in 17 NCAC 05G .1004. If Financial Institution Corp knows its customer's state of primary residence, it must source the receipts to that state. If Financial Institution Corp does not know its customer's state of primary residence, but rather knows the customer's billing address, it must source the receipts to that state. Financial Institution Corp's receipts are sourced to North Carolina if the customer's state of primary residence (or billing address, in cases when the customer's state of primary residence is not known) is in North Carolina, even if Financial Institution Corp's financial custodial work, including the safekeeping of the customer's financial assets, takes place in a state other than North Carolina. [See 17 NCAC 05G .1004.](#)

*Example 8:* Same facts as Example 7, except that Financial Institution Corp has more than 250 customers, individual or business. Financial Institution Corp may apply the safe harbor for professional services stated in [17 NCAC 05G .1004](#), and may source its receipts from sales to a state or states using each customer's billing address.

*Example 9:* Same facts as Example 8, except that Financial Institution Corp derives more than five percent (5%) of its receipts from sales from a single individual customer. As to the sales made to this customer, Financial Institution Corp is required to determine the individual customer's state of primary residence and must source the receipts from the service or services provided to that customer to that state. [See 17 NCAC 05G .1004](#). Receipts from sales to all other customers are sourced as described in Example 8.

*Example 10:* Advisor Corp, a corporation that provides investment advisory services, provides these advisory services to Investment Co. Investment Co is a multistate business client of Advisor Corp that uses Advisor Corp's services in connection with investment accounts that it manages for individual clients, who are the ultimate beneficiaries of Advisor Corp's services. Assume that Investment Co's individual clients are persons that reside in numerous states, which may or may not include North Carolina. Assuming that Advisor Corp knows that its agreement with Investment Co is principally managed by Investment Co in North Carolina, receipts from the sale of Advisor Corp's services are sourced to North Carolina. It is not relevant for purposes of the analysis that the ultimate beneficiaries of Advisor Corp's services may be Investment Co's clients, who are residents of numerous states. [See 17 NCAC 05G .1004.](#)

*Example 11:* Advisor Corp provides investment advisory services to Investment Fund LP, a partnership that invests in securities and other assets. Assuming that Advisor Corp knows that its agreement with Investment Fund LP is principally managed by Investment Fund LP in North Carolina, receipts from the sale of Advisor Corp's services are sourced to North Carolina. [See 17 NCAC 05G .1004.](#)

Note that it is not relevant for purposes of the analysis that the partners in Investment Fund LP are residents of numerous states.

*Example 12:* Design Corp is a corporation based outside North Carolina that provides graphic design and similar services in North Carolina and in neighboring states. Design Corp enters into a contract at a location outside North Carolina with an individual customer to design fliers for the customer. Assume that Design Corp does not know the individual customer's state of primary residence and does not derive more than five percent (5%) of its receipts from sales of services from the individual customer. All of the design work is performed outside North Carolina. Receipts from the sale are in North Carolina if the customer's billing address is in North Carolina. [See 17 NCAC 05G .1004.](#)

**d. Services Delivered to a Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer ([17 NCAC 05G .0901](#))**

If the service is not an in-person service (see subsection b) or professional service (see subsection c), and the service is delivered to or on behalf of the customer, or delivered electronically through the customer, the receipts from the sale are in North Carolina to the extent that the service is delivered in North Carolina. A service may be delivered to or on behalf of a customer by physical means or through electronic transmission. [See 17 NCAC 05G .0901](#) for the definitions that apply to this subsection.

Assignment of receipts to North Carolina from sales of services delivered to the customer or on behalf of the customer, or delivered electronically through the customer are discussed in [17 NCAC 05G .0902](#).

Delivery by Physical Means:

The delivery to or on behalf of a customer by physical means, whether to an individual or business customer is discussed in [17 NCAC 05G .0903](#) and is summarized below:

- **Delivery to or on behalf of a customer by physical means – individual or business customer:** To the extent the service is actually delivered to the customer or the customer's customer in North Carolina; or, if not determinable, by reasonable approximation based upon information available regarding place of delivery.

*Examples (Delivery by Physical Means):*

*Example 1:* Direct Mail Corp, a corporation based outside North Carolina, provides direct mail services to its customer, Business Corp. Business Corp transacts with Direct Mail Corp to deliver printed fliers to a list of customers that is provided to it by Business Corp. Some of Business Corp's customers are in

North Carolina and some of those customers are in other states. Direct Mail Corp will use the postal service to deliver the printed fliers to Business Corp's customers. The receipts from the sale of Direct Mail Corp's services to Business Corp are sourced to North Carolina to the extent that the services are delivered on behalf of Business Corp to North Carolina customers (i.e., to the extent that the fliers are delivered on behalf of Business Corp to Business Corp's intended audience in North Carolina).

*Example 2:* Ad Corp is a corporation based outside North Carolina that provides advertising and advertising-related services in North Carolina and in neighboring states. Ad Corp enters into a contract at a location outside North Carolina with an individual customer who is not a North Carolina resident to design advertisements for billboards to be displayed in North Carolina, and to design fliers to be mailed to North Carolina residents. All of the design work is performed outside North Carolina. The receipts from the sale of the design services are in North Carolina because the service is physically delivered on behalf of the customer to the customer's intended audience in North Carolina.

*Example 3:* Same facts as Example 2, except that the contract is with a business customer that is based outside North Carolina. The receipts from the sale of the design services are in North Carolina because the services are physically delivered on behalf of the customer to the customer's intended audience in North Carolina.

*Example 4:* Fulfillment Corp, a corporation based outside North Carolina, provides product delivery fulfillment services in North Carolina and in neighboring states to Sales Corp, a corporation located outside North Carolina that sells tangible personal property through a mail order catalog and over the internet to customers. In some cases when a customer purchases tangible personal property from Sales Corp to be delivered in North Carolina, Fulfillment Corp will, pursuant to its contract with Sales Corp, deliver that property from its fulfillment warehouse located outside North Carolina. The receipts from the sale of the fulfillment services of Fulfillment Corp to Sales Corp are sourced to North Carolina to the extent that Fulfillment Corp's deliveries on behalf of Sales Corp are to recipients in North Carolina.

*Example 5:* Software Corp, a software development corporation, enters into a contract with a business customer, Buyer Corp, to develop custom software to be used in Buyer Corp's business. Software Corp develops the custom software outside North Carolina, and then physically installs the software on Buyer Corp's computer hardware located in North Carolina. The development and sale of the custom software is properly characterized as a service transaction, and the receipts from the sale are sourced to North Carolina because the software is physically delivered to the customer in North Carolina.

*Example 6:* Same facts as Example 5, except that Buyer Corp has offices in North Carolina and several other states but is commercially domiciled outside North Carolina and orders the software from a location outside North Carolina. The receipts from the development and sale of the custom software service are sourced to North Carolina because the software is physically delivered to the customer in North Carolina.

Delivery by Electronic Transmission:

The assignment of receipts to North Carolina from the delivery to a customer by electronic transmission is discussed in [17 NCAC 05G .0904](#) and is summarized below:

- **Delivery to a customer by electronic transmission – individual customer:** To the extent the customer actually receives the service in North Carolina; or, if not determinable, by reasonable approximation as follows (in order of priority): (i) based upon sufficient information regarding the customer's place of receipt; or (ii) if insufficient information regarding place of receipt, based upon the customer's billing address.
- **Delivery to a customer by electronic transmission – business customer:** To the extent the service is directly used by the customer's employees or designees in North Carolina; or, if not reasonably determinable, reasonably approximate as follows (in order of priority): (i) if sufficient information regarding location where directly used by the customer's employees or designees, based upon the location where directly used by the customer's employees or designees; (ii) if insufficient information, as follows (in order of priority: a. based upon where the contract is principally managed by the customer, b. if not reasonably determinable, based upon the customer's place of order, or c. if not reasonably determinable, based upon the customer's billing address (but must use state where the customer principally managed the contract if more than 5% ( $>5\%$ ) of sales of services are from that customer); or (iii) where engaged in substantially similar transactions with more than 250 customers ( $>250$ ), does not derive more than 5% ( $>5\%$ ) of sales from the customer and cannot reasonably approximate under (i), may assign on the basis of the customer's billing address.
- **Optional safe harbor, electronic delivery of a service – provided to a business customer (if substantially similar service transactions with more than 250 business or individual customers and less than five percent ( $< 5\%$ ) of the taxpayer's sales of services are from that customer):** If North Carolina is the customer's billing address.
- **Related entity delivery by electronic transmission – business customer:** To the extent the service is directly used by the customer's

employees or designees in North Carolina; or, if not reasonably determinable, reasonably approximate if sufficient information regarding location where directly used by the customer's employees or designees, based upon the location where directly used by the customer's employees or designees. May use safe harbor, provided that sales may be aggregated to related parties in determining whether the sales exceed 5% of receipts from sales of all services.

*Examples (Delivery by Electronic Transmission):*

Unless otherwise stated, assume that the taxpayer is not related to the customer to which the service is delivered. Also, assume if relevant, unless otherwise stated, that the safe harbor set forth in [17 NCAC 05G .0904](#) does not apply.

*Example 1:* Support Corp, a corporation that is based outside North Carolina, provides software support and diagnostic services to individual and business customers that have previously purchased certain software from third-party vendors. These individual and business customers are located in North Carolina and other states. Support Corp supplies its services on a case-by-case basis when directly contacted by its customer. Support Corp generally provides these services through the internet but sometimes provides these services by phone. In all cases, Support Corp verifies the customer's account information before providing any service. Using the information that Support Corp verifies before performing a service, Support Corp can determine where its services are received, and therefore must source its receipts to these locations. The receipts from sales made to Support Corp's individual and business customers are in North Carolina to the extent that Support Corp's services are received in North Carolina. [See 17 NCAC 05G .0904.](#)

*Example 2:* Online Corp, a corporation based outside North Carolina, provides web-based services through the means of the internet to individual customers who reside in North Carolina and in other states. These customers access Online Corp's web services primarily in their states of residence, and sometimes, while traveling, in other states. For a substantial portion of its receipts from the sale of services, Online Corp can either determine the state or states where the services are received, or, when it cannot determine the state or states, it has sufficient information regarding the place of receipt to reasonably approximate the state or states. However, Online Corp cannot determine or reasonably approximate the state or states of receipt for all of the sales of its services. Online Corp reasonably believes that based on all available information, the geographic distribution of the receipts from sales for which it cannot determine or reasonably approximate the location of the receipt of its services generally tracks those for which it does have this information. Online Corp must source the receipts from sales for which it does not know the customers' location in the same proportion as those receipts for which it has this information. [See 17 NCAC 05G .0302.](#)

*Example 3:* Same facts as in Example 2, except that Online Corp reasonably believes that the geographic distribution of the receipts from sales for which it cannot determine or reasonably approximate the location of the receipt of its web-based services do not generally track the sales for which it does have this information. Online Corp must source the receipts from sales of its services for which it lacks information as provided to its individual customers using the customers' billing addresses. See [17 NCAC 05G .0904](#).

*Example 4:* Net Corp, a corporation based outside North Carolina, provides web-based services to a business customer, Business Corp, a company with offices in North Carolina and two neighboring states. Particular employees of Business Corp access the services from computers in each Business Corp office. Assume that Net Corp determines that Business Corp employees in North Carolina were responsible for 75% of Business Corp's use of Net Corp's services, and Business Corp employees in other states were responsible for twenty five percent (25%) of Business Corp's use of Net Corp's services. In this case, seventy five percent (75%) of the receipts from the sale are received in North Carolina. See [17 NCAC 05G .0904](#).

Assume alternatively that Net Corp lacks sufficient information regarding the location or locations where Business Corp's employees used the services to determine or reasonably approximate the location or locations. Under these circumstances, if Net Corp derives five percent (5%) or less of its receipts from sales to Business Corp, Net Corp must source the receipts under [17 NCAC 05G .0904](#) to the state where Business Corp principally managed the contract, or if that state is not reasonably determinable, to the state where Business Corp placed the order for the services, or if that state is not reasonably determinable, to the state of Business Corp's billing address. If Net Corp derives more than 5% of its receipts from sales of services to Business Corp, Net Corp is required to identify the state in which its contract of sale is principally managed by Business Corp and must source the receipts to that state.

*Example 5:* Net Corp, a corporation based outside North Carolina, provides web-based services through the means of the internet to more than 250 individual and business customers in North Carolina and in other states. Assume that for each customer Net Corp cannot determine the state or states where its web services are actually received and lacks sufficient information regarding the place of receipt to reasonably approximate the state or states. Also assume that Net Corp does not derive more than five percent (5%) of its receipts from sales of services to a single customer. Net Corp may apply the safe harbor stated in [17 NCAC 05G .0904](#), and may source its receipts using each customer's billing address.

Assigning receipts to North Carolina from services delivered electronically through or on behalf of an individual or business customer is discussed in [17 NCAC 05G .0905](#) and is summarized below:

- **Delivery through or on behalf of a customer through electronic transmission – general rule:** To the extent the end-user or other third-party recipient is actually in North Carolina, or, if not determinable, by reasonable approximation based upon sufficient information regarding place of delivery.
- **Delivery through or on behalf of a customer through electronic transmission – advertising service:** To the extent the audience for the advertising is in North Carolina, or, if insufficient information, reasonably approximate as follows (in order of priority): (i) based upon the location of the audience, or (ii), if insufficient information, based upon a percentage that reflects the ratio of North Carolina's population in the specific geographic area in which the advertising is delivered relative to the total population in such area.
- **Delivery through or on behalf of a customer through electronic transmission – customer is a reseller:** To the extent the end-user or other third-party recipients receive such services in North Carolina, or, if not determinable, reasonably approximate as follows (in order of priority): (i) based upon sufficient information regarding place of delivery, or (ii) if insufficient information, based upon a percentage that reflects the ratio of the North Carolina geographic area in which the customer reseller resells such services relative to the total population in such area.

*Examples (Services Delivered Electronically Through or on Behalf of an Individual or Business Customer):*

*Example 1:* Cable TV Corp, a corporation that is based outside of North Carolina, has two revenue streams. First, Cable TV Corp sells advertising time to business customers pursuant to which the business customers' advertisements will run as commercials during Cable TV Corp's televised programming. Some of these business customers, though not all of them, have a physical presence in North Carolina. Second, Cable TV Corp sells monthly subscriptions to individual customers in North Carolina and in other states. The receipts from Cable TV Corp's sale of advertising time to its business customers are sourced to North Carolina to the extent that the audience for Cable TV Corp's televised programming during which the advertisements run is in North Carolina. *See [17 NCAC 05G .0905](#)*. If Cable TV Corp is unable to determine the actual location of its audience for the programming, and lacks sufficient information regarding audience location to reasonably approximate the location, Cable TV Corp must approximate its North Carolina audience using the percentage that reflects the ratio of its North Carolina subscribers in the geographic area in which Cable TV Corp's televised programming featuring the advertisements is delivered relative to its total number of subscribers in that area. *See [17 NCAC 05G .0905](#)*. To the extent that Cable TV Corp's sales of monthly subscriptions represent the sale of

a service, the receipts from these sales are properly sourced to North Carolina in any case in which the programming is received by a customer in North Carolina. *See [17 NCAC 05G .0904](#).*

In any case in which Cable TV Corp cannot determine the actual location where the programming is received and lacks sufficient information regarding the location of receipt to reasonably approximate the location, the receipts from these sales of Cable TV Corp's monthly subscriptions are sourced to North Carolina where its customer's billing address is in North Carolina. *See [17 NCAC 05G .0904](#).* Note that whether and to the extent that the monthly subscription fee represents a fee for a service, or for a license of intangible property, does not affect the analysis or result as to the state or states to which the receipts are properly sourced. *See [17 NCAC 05G .1105](#).*

To determine if Cable TV Corp meets the definition and apportionment requirements of a Wholesale Content Distributor, *see [Section J, 3](#).*

*Example 2:* Network Corp, a corporation that is based outside of North Carolina, sells advertising time to business customers pursuant to which the customers' advertisements will run as commercials during Network Corp's televised programming as distributed by unrelated cable television and satellite television transmission companies. The receipts from Network Corp's sale of advertising time to its business customers are sourced to North Carolina to the extent that the audience for Network Corp's televised programming during which the advertisements will run is in North Carolina. *See [17 NCAC 05G .0905](#).*

If Network Corp cannot determine the actual location of the audience for its programming during which the advertisements will run, and lacks sufficient information regarding audience location to reasonably approximate the location, Network Corp must approximate the receipts from sales of advertising that constitute North Carolina sales by multiplying the amount of advertising receipts by a percentage that reflects the ratio of the North Carolina population in the specific geographic area in which the televised programming containing the advertising is run relative to the total population in that area. *See [17 NCAC 05G .0905](#).*

To determine if Network Corp meets the definition and apportionment requirements of a Wholesale Content Distributor, *see [Section J, 3](#).*

*Example 3:* Web Corp, a corporation that is based outside North Carolina, provides internet content to viewers in North Carolina and other states. Web Corp sells advertising space to business customers pursuant to which the customers' advertisements will appear in connection with Web Corp's internet content. Web Corp receives a fee for running the advertisements that is determined by reference to the number of times the advertisement is viewed or clicked upon by the viewers of its website. The receipts from Web Corp's sale of advertising space to its

business customers are sourced to North Carolina to the extent that the viewers of the internet content are in North Carolina, as measured by viewings or clicks. *See [17 NCAC 05G .0905](#).*

If Web Corp is unable to determine the actual location of its viewers, and lacks sufficient information regarding the location of its viewers to reasonably approximate the location, Web Corp must approximate the amount of its North Carolina receipts by multiplying the amount of receipts from sales of advertising by a percentage that reflects the North Carolina population in the specific geographic area in which the content containing the advertising is delivered relative to the total population in that area. *See [17 NCAC 05G .0905](#).*

*Example 4:* Retail Corp, a corporation that is based outside of North Carolina, sells tangible property through its retail stores located in North Carolina and other states, and through a mail order catalog. Answer Co, a corporation that operates call centers in multiple states, contracts with Retail Corp to answer telephone calls from individuals placing orders for products found in Retail Corp's catalogs. In this case, the phone answering services of Answer Co are being delivered to Retail Corp's customers and prospective customers. Therefore, Answer Co is delivering a service electronically to Retail Corp's customers or prospective customers on behalf of Retail Corp and must source the proceeds from this service to the state or states from which the phone calls are placed by the customers or prospective customers.

If Answer Co cannot determine the actual locations from which phone calls are placed, and lacks sufficient information regarding the locations to reasonably approximate the locations, Answer Co must approximate the amount of its North Carolina sales by multiplying the amount of its fee from Retail Corp by a percentage that reflects the North Carolina population in the specific geographic area from which the calls are placed relative to the total population in that area. *See [17 NCAC 05G .0905](#).*

*Example 5:* Web Corp, a corporation that is based outside of North Carolina, sells tangible property to customers via its internet website. Design Co. designed and maintains Web Corp's website, including making changes to the site based on customer feedback received through the site. Design Co.'s services are delivered to Web Corp, the proceeds from which are sourced pursuant to [17 NCAC 05G .0905](#). The fact that Web Corp's customers and prospective customers incidentally benefit from Design Co.'s services and may even interact with Design Co. in the course of providing feedback, does not transform the service into one delivered "on behalf of" Web Corp to Web Corp's customers and prospective customers.

*Example 6:* Data Corp, a corporation that is based outside North Carolina, develops an internet-based information database outside North Carolina and enters into a contract with Retail Corp whereby Retail Corp will market and sell access to this database to end users. Depending on the facts, the provision of

database access may be either the sale of a service or the license of intangible property or may have elements of both. Assume that based on the particular facts applicable in this example, Data Corp is selling database access in transactions properly characterized as involving the performance of a service. When an end user purchases access to Data Corp's database from Retail Corp, Retail Corp in turn compensates Data Corp in connection with that transaction. In this case, Data Corp's services are being delivered through Retail Corp to the end user. Data Corp must source its receipts from sales to Retail Corp to the state or states in which the end users receive access to Data Corp's database.

If Data Corp cannot determine the state or states where the end users actually receive access to Data Corp's database, and lacks sufficient information regarding the location from which the end users access the database to reasonably approximate the location, Data Corp must approximate the extent to which its services are received by end users in North Carolina by using a percentage that reflects the ratio of the North Carolina population in the specific geographic area in which Retail Corp regularly markets and sells Data Corp's database relative to the total population in that area. *See [17 NCAC 05G .0905](#)*. Note that it does not matter for purposes of the analysis whether Data Corp's sale of database access constitutes a service or a license of intangible property, or some combination of both. *See [17 NCAC 05G .1105](#)*.

**e. License or Lease of Intangible Property ([17 NCAC 05G .1101](#))**

In general, the receipts from the license of intangible property are assigned to North Carolina to the extent the intangible property is used in North Carolina.

For the rule on assigning receipts from the license of a marketing intangible, see [17 NCAC 05G .1102](#).

For the rule on assigning receipts from the license of a production intangible, see [17 NCAC 05G .1103](#).

For the rule on assigning receipts from the license of a mixed intangible, see [17 NCAC 05G .1104](#).

For the rule on assigning receipts from the license of intangible property when substance of the transaction resembles a sale of goods or services, see [17 NCAC 05G .1105](#).

**Examples (License or Lease of Intangible Property):**

*Example 1:* Crayon Corp and Dealer Co. enter into a license contract under which Dealer Co. as licensee is permitted to use trademarks that are owned by Crayon Corp in connection with Dealer Co.'s sale of certain products to retail customers. Under the contract, Dealer Co. is required to pay Crayon Corp a licensing fee that

is a fixed percentage of the total volume of monthly sales made by Dealer Co. of products using the Crayon Corp trademarks. Under the contract, Dealer Co. is permitted to sell the products at multiple store locations, including store locations that are both within and without North Carolina. Further, the licensing fees that are paid by Dealer Co. are broken out on a per-store basis. The licensing fees paid to Crayon Corp by Dealer Co. represent fees from the license of a marketing intangible. The portion of the fees to be sourced to North Carolina are determined by multiplying the fees by a percentage that reflects the ratio of Dealer Co.'s receipts that are derived from its North Carolina stores relative to Dealer Co.'s total receipts. *See [17 NCAC 05G .1102](#).*

*Example 2:* Program Corp, a corporation that is based outside North Carolina, licenses programming that it owns to licensees, such as cable networks, that in turn will offer the programming to their customers on television or other media outlets in North Carolina and in all other U.S. states. Each of these licensing contracts constitutes the license of a marketing intangible. For each licensee, assuming that Program Corp lacks evidence of the actual number of viewers of the programming in North Carolina, the component of the licensing fee paid to Program Corp by the licensee that constitutes Program Corp's North Carolina receipts is determined by multiplying the amount of the licensing fee by a percentage that reflects the ratio of the North Carolina audience of the licensee for the programming relative to the licensee's total U.S. audience for the programming. *See [17 NCAC 05G .1101](#).* Note that the analysis and result as to the state or states to which receipts are properly sourced would be the same to the extent that the substance of Program Corp's licensing transactions may be determined to resemble a sale of goods or services, instead of the license of a marketing intangible. *See [17 NCAC 05G .1105](#).*

To determine if Program Corp meets the definition and apportionment requirements of a Wholesale Content Distributor, see [Section J, 3](#).

*Example 3:* Moniker Corp enters into a license contract with Warehouse Co. Pursuant to the contract, Warehouse Co is granted the right to use trademarks owned by Moniker Corp to brand sports equipment that is to be manufactured by Warehouse Co or an unrelated entity, and to sell the manufactured equipment to unrelated companies that will ultimately market the equipment to consumers in a specific geographic region, including a foreign country. The license agreement confers a license of a marketing intangible, even though the trademarks in question will be affixed to property to be manufactured. In addition, the license of the marketing intangible is for the right to use the intangible property in connection with sales to be made at wholesale rather than directly to retail customers. The component of the licensing fee that constitutes the North Carolina receipts of Moniker Corp is determined by multiplying the amount of the fee by a percentage that reflects the ratio of the North Carolina population in the specific geographic region relative to the total population in that region. *See [17 NCAC 05G .1102](#).* If Moniker Corp is able to reasonably establish that the marketing

intangible was materially used throughout a foreign country, then the population of that country will be included in the population ratio calculation. However, if Moniker Corp is unable to reasonably establish that the marketing intangible was materially used in the foreign country in areas outside a particular major city; then none of the foreign country's population beyond the population of the major city is included in the population ratio calculation.

*Example 4:* Formula, Inc. and Appliance Co enter into a license contract under which Appliance Co is permitted to use a patent owned by Formula, Inc. to manufacture appliances. The license contract specifies that Appliance Co is to pay Formula, Inc. a royalty that is a fixed percentage of the gross receipts from the products that are later sold. The contract does not specify any other fees. The appliances are both manufactured and sold in North Carolina and several other states. Assume the licensing fees are paid for the license of a production intangible, even though the royalty is to be paid based upon the sales of a manufactured product (i.e., the license is not one that includes a marketing intangible). Because the actual use of the intangible property takes place in part in North Carolina, the royalty is sourced based to the location of that use rather than to the location of the licensee's commercial domicile, in accordance with [17 NCAC 05G .1101](#). It is presumed that the entire use is in North Carolina except to the extent that the taxpayer can demonstrate that the actual location of some or all of the use takes place outside North Carolina. Assuming that Formula, Inc. can demonstrate the percentage of manufacturing that takes place in North Carolina using the patent relative to the manufacturing in other states, that percentage of the total licensing fee paid to Formula, Inc. under the contract will constitute Formula, Inc.'s North Carolina receipts. See [17 NCAC 05G .1105](#).

*Example 5:* Axel Corp enters into a license agreement with Biker Co in which Biker Co is granted the right to produce motor scooters using patented technology owned by Axel Corp, and also to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The contract is a license of both a marketing and production intangible, i.e., a mixed intangible. The scooters are manufactured outside North Carolina. Assume that Axel Corp lacks actual information regarding the proportion of Biker Co's receipts that are derived from North Carolina customers. Also assume that Biker Co is granted the right to sell the scooters in a U.S. geographic region in which the North Carolina population constitutes twenty five percent (25%) of the total population during the period in question. The licensing contract requires an upfront licensing fee to be paid by Biker Co to Axel Corp and does not specify what percentage of the fee derives from Biker Co's right to use Axel Corp's patented technology. Because the fees for the license of the marketing and production intangible are not separately and reasonably stated in the contract, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible, unless the taxpayer reasonably establishes otherwise. Assuming the taxpayer does not establish otherwise, twenty five percent (25%) of the licensing fee constitutes North Carolina receipts. See [17 NCAC 05G .1102](#) and [.1104](#).

*Example 6:* Same facts as Example 5, except that the license contract specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing contract constitutes both the license of a marketing intangible and the license of a production intangible. Assuming that the separately stated fees are reasonable, (1) no part of the licensing fee paid for the production intangible will be sourced to North Carolina, and (2) twenty five percent (25%) of the licensing fee paid for the marketing intangible will be sourced to North Carolina. *See [17 NCAC 05G .1104](#).*

*Example 7:* Better Burger Corp, which is based outside North Carolina, enters into franchise contracts with franchisees that agree to operate Better Burger restaurants as franchisees in various states. Several of the Better Burger Corp franchises are in North Carolina. In each case, the franchise contract between the individual and Better Burger Corp provides that the franchisee is to pay Better Burger Corp an upfront fee for the receipt of the franchise and monthly franchise fees, which cover, among other things, the right to use the Better Burger name and service marks, food processes and cooking know-how, as well as fees for management services. The upfront fees for the receipt of the North Carolina franchises constitute fees paid for the licensing of a marketing intangible. These fees constitute North Carolina receipts because the franchises are for the right to make North Carolina sales. The monthly franchise fees paid by North Carolina franchisees constitute fees paid for (1) the license of marketing intangibles (the Better Burger name and service marks), (2) the license of production intangibles (food processes and know-how) and (3) personal services (management fees). The fees paid for the license of the marketing intangibles and the production intangibles constitute North Carolina receipts because in each case the use of the intangibles is to take place in North Carolina. *See [17 NCAC 05G .1102-.1104](#).* The fees paid for the personal services are to be sourced pursuant to G.S. § 105-130.4(l)(3).

*Example 8:* Online Corp, a corporation based outside North Carolina, licenses an information database through the means of the internet to individual customers that reside in North Carolina and in other states. These customers access Online Corp's information database primarily in their states of residence, and sometimes, while traveling, in other states. The license is a license of intangible property that resembles a sale of goods or services and are sourced in accordance with *[17 NCAC 05G .1105](#)*. If Online Corp can determine or reasonably approximate the state or states where its database is accessed, it must do so. Assuming that Online Corp cannot determine or reasonably approximate the location where its database is accessed, Online Corp must source the receipts made to the individual customers using the customers' billing addresses to the extent known. Assume for purposes of this example, that Online Corp knows the billing address for each of its customers. In this case, Online Corp's receipts from sales made to its individual customers are in North Carolina in any instance in which the customer's billing address is in North Carolina. *See [17 NCAC 05G .0904](#).*

*Example 9:* Net Corp, a corporation based outside North Carolina, licenses an information database through the means of the internet to a business customer, Business Corp, a company with offices in North Carolina and two neighboring states. The license is a license of intangible property that resembles a sale of goods or services, and is sourced in accordance with [17 NCAC 05G .1105](#). Assume that Net Corp cannot determine where its database is accessed, but reasonably approximates that seventy five percent (75%) of Business Corp's database access took place in North Carolina, and twenty five percent (25%) of Business Corp's database access took place in other states. In that case, seventy five percent (75%) of the receipts from database access are in North Carolina. Assume alternatively that Net Corp lacks sufficient information regarding the location where its database is accessed to reasonably approximate the location. Under these circumstances, if Net Corp derives five percent (5%) or less of its receipts from database access from Business Corp, Net Corp must source the receipts under [17 NCAC 05G .0904](#) to the state where Business Corp principally managed the contract, or if that state is not reasonably determinable to the state where Business Corp placed the order for the services, or if that state is not reasonably determinable to the state of Business Corp's billing address. If Net Corp derives more than five percent (5%) of its receipts from database access from Business Corp, Net Corp is required to identify the state in which its contract of sale is principally managed by Business Corp and must source the receipts to that state. *See* [17 NCAC 05G .0904](#).

*Example 10:* Net Corp, a corporation based outside North Carolina, licenses an information database through the means of the internet to more than 250 individual and business customers in North Carolina and in other states. The license is a license of intangible property that resembles a sale of goods or services, and receipts from that license is sourced in accordance with [17 NCAC 05G .1105](#). Assume that Net Corp cannot determine or reasonably approximate the location where its information database is accessed. Also assume that Net Corp does not derive more than five percent (5%) of its receipts from sales of database access from any single customer. Net Corp may apply the safe harbor stated in [17 NCAC 05G .0904](#), and may source its receipts to a state or states using each customer's billing address.

*Example 11:* Web Corp, a corporation based outside of North Carolina, licenses an internet-based information database to business customers who then sublicense the database to individual end users that reside in North Carolina and in other states. These end users access Web Corp's information database primarily in their states of residence, and sometimes, while traveling, in other states. Web Corp's license of the database to its customers includes the right to sublicense the database to end users, while the sublicenses provide that the rights to access and use the database are limited to the end users' own use and prohibit the individual end users from further sublicensing the database. Web Corp receives a fee from each customer based upon the number of sublicenses issued to end users. The license is a license of intangible property that resembles a sale

of goods or services and are sourced by applying the rules set forth in [17 NCAC 05G .0905](#). See [17 NCAC 05G .1105](#).

If Web Corp can determine or reasonably approximate the state or states where its database is accessed by end users, it must do so. Assuming that Web Corp lacks sufficient information from which it can determine or reasonably approximate the location where its database is accessed by end users, Web Corp must approximate the extent to which its database is accessed in North Carolina using a percentage that represents the ratio of the North Carolina population in the specific geographic area in which Web Corp's customer sublicenses the database access relative to the total population in that area. See [17 NCAC 05G .0905](#).

**f. Sale of Intangible Property ([17 NCAC 05G .1201](#))**

A contract right or government license that authorizes business activity in a specific geographic area is sourced to North Carolina to the extent that the property is used or is authorized to be used in North Carolina, or through reasonable approximation. A sale that resembles a license or a sale that resembles a sale of goods or services is sourced to North Carolina as required under rule [17 NCAC 05G .1201](#). Examples are below.

The following sales are excluded from the numerator and denominator of the sales factor: securities, business goodwill, agreement not to compete, workforce in place, and other similar intangible value.

*Examples (Sale of Intangible Property):*

*Example 1:* Airline Corp, a corporation based outside North Carolina, sells its rights to use several gates at an airport located in North Carolina to Buyer Corp, a corporation that is based outside North Carolina. The contract of sale is negotiated and signed outside of North Carolina. The receipts from the sale are in North Carolina because the intangible property sold is a contract right that authorizes the holder to conduct a business activity solely in North Carolina. See [17 NCAC 05G .1201](#).

*Example 2:* Wireless Corp, a corporation based outside North Carolina, sells a license issued by the Federal Communications Commission (FCC) to operate wireless telecommunications services in a designated area in North Carolina to Buyer Corp, a corporation that is based outside North Carolina. The contract of sale is negotiated and signed outside of North Carolina. The receipts from the sale are in North Carolina because the intangible property sold is a government license that authorizes the holder to conduct business activity solely in North Carolina. See [17 NCAC 05G .1201](#).

*Example 3:* Same facts as in Example 2 except that Wireless Corp sells to Buyer Corp an FCC license to operate wireless telecommunications services in a designated area in North Carolina and an adjacent state. Wireless Corp must attempt to reasonably approximate the extent to which the intangible property is used in or may be used in North Carolina. For purposes of making this reasonable approximation, Wireless Corp may rely upon credible data that identifies the percentage of persons that use wireless telecommunications in the two states covered by the license. *See [17 NCAC 05G .1201](#).*

*Example 4:* Sports League Corp, a corporation that is based outside North Carolina, sells the rights to broadcast the sporting events played by the teams in its league in all 50 of the United States to Network Corp. Although the games played by Sports League Corp will be broadcast in all 50 states, the games are of greater interest in the eastern region of the country, including North Carolina. Because the intangible property sold is a contract right that authorizes the holder to conduct a business activity in a specified geographic area, Sports League Corp must attempt to reasonably approximate the extent to which the intangible property is used in or may be used in North Carolina. For purposes of making this reasonable approximation, Sports League Corp may rely upon audience measurement information that identifies the percentage of the audience for its sporting events in North Carolina and the other states. *See [17 NCAC 05G .1201](#).*

*Example 5:* Inventor Corp, a corporation that is based outside North Carolina, sells patented technology that it has developed to Buyer Corp, a business customer that is based in North Carolina. Assume that the sale is not one in which the receipts are derived from payments that are contingent on the productivity, use, or disposition of the property and it does not resemble a sale of goods or services. *See [17 NCAC 05G .1201](#).* Inventor Corp understands that Buyer Corp is likely to use the patented technology in North Carolina, but the patented technology can be used anywhere (i.e., the rights sold are not rights that authorize the holder to conduct a business activity in a specific geographic area). The receipts from the sale of the patented technology are excluded from the numerator and denominator of Inventor Corp's sales factor. *See [17 NCAC 05G .1201](#).*

#### **g. Special Rules**

##### Software Transactions ([17 NCAC 05G .1301](#))

Software transferred by tangible medium is treated as a sale of tangible personal property and is not treated as the license or sale of intangible property or the performance of a service.

In all other cases, software is sourced as otherwise required under the intangible property sourcing rules.

## Sales or Licenses of Digital Goods and Services ([17 NCAC 05G .1302](#))

Receipts from a sale or license of digital goods or services are assigned as if the transaction was a service delivered to an individual or business customer, or delivered through or on behalf of an individual or business customer.

## Telecommunications Companies

For information on sourcing rules for telecommunications companies, see: [17 NCAC 05G .1303](#).

## **2. Special Apportionment Factors (G.S. § [105-130.4](#))**

### **a. Preliminary Statement**

Special apportionment provisions apply to certain types of corporations and excluded corporations. G.S. § [105-130.4](#) should be consulted for definitions and specific apportionment and allocation requirements. The Department refers to the North American Industry Classification System (NAICS) as a means of determining whether a taxpayer's business operations require the corporation to use the special apportionment provisions.

### **b. 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. The records used to apportion income must be in conformance with GAAP.

### **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. 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. A qualified air freight forwarder shall use the revenue ton mile fraction of its affiliated air carrier.

The following definitions apply:

Air carrier. – A corporation engaged in the business of transporting any combination of passengers or property of any kind in interstate commerce, and the majority of the corporation's revenue ton miles everywhere are attributed to transportation by aircraft.

Air transportation corporation. – One or more of the following:

- a. An air carrier that carries any combination of passengers or property of any kind.
- b. A qualified air freight forwarder.

Qualified air freight forwarder. – A corporation that is an affiliate of an air carrier and whose air freight forwarding business is primarily carried on with the affiliated air carrier.

Revenue ton-mile. - One ton of passengers, freight, rail, or other cargo carried one mile by aircraft, motor vehicle, or vessel. In making this computation, a passenger is considered to weigh two hundred pounds.

**e. Pipeline Companies**

Receipts from transportation of a petroleum-based liquids or natural gas pipeline company shall be apportioned by multiplying the income by a fraction, the numerator of which is the number of traffic units in this State during the tax year and the denominator of which is the total number of traffic units everywhere during the tax year. Traffic units are defined as barrel miles or cubic foot miles. The definition of a "barrel mile" is one barrel of liquid property transported one mile. The definition of a "cubic foot mile" is one cubic foot of gaseous property transported one mile.

**f. Electric Power Companies**

Special apportionment rules apply to corporations that qualify as electric power companies. A company, including any of its wholly owned noncorporate limited liability companies, that is primarily engaged in the business of supplying electricity for light, heat, current, or power to persons in this State that is subject to control of the N.C. Utilities Commission, or the Federal Energy Regulatory Commission meets the definition of an electric power company.

The numerator of its apportionment factor is the average value of real and tangible personal property owned or rented and used in this State during the tax year and the denominator is the average value of real and tangible personal property owned or rented and used everywhere during the tax year. The average value of real and tangible personal property owned or rented is determined as follows:

1. The average value of property is determined by averaging the values at the beginning and end of the tax year. The Secretary may require averaging of monthly or other periodic values during the tax year if it more accurately reflects the average value of the property.
2. If an electric power company ends its operations in this State before the end of its tax year, it must use the real estate and tangible personal property values as of the first day

of the tax year and the last day of its operations in this State to determine the average value of the property. The Secretary may require averaging of monthly or other periodic values during the tax year if it more accurately reflects the average value of the property.

3. Owned property is valued at its original cost.
4. Rented property is valued at eight times the net annual rental rate.
5. The net annual rate is the annual rental rate paid less any annual rental rate received from sub-rentals. Sub-rentals are not deducted if they are apportionable income.
6. Any property under construction and any property's income that is nonapportionable income is not included in the computation of the average value of the company's real and tangible personal property.

**3. Wholesale Content Distributor Apportionment Factor (G.S. §§ [105-130.4\(l1\)](#), [105-130.4A](#))**

**a. Definitions**

A “wholesale content distributor” is defined as a broadcast television network, a cable program network, or any television distribution company owned by, affiliated with, or under common ownership with any such network and does not mean or include a multichannel video programming distributor or a distributor of subscription-based internet programming services.

A “customer” is defined as a person who has a direct contractual relationship with a wholesale content distributor from whom the wholesale content distributor derives gross receipts, including a business customer such as an advertiser or licensee, and an individual customer that directly subscribes with the wholesale content distributor for access to film programming. Gross receipts have the same meaning as the term "sales" in G.S. § [105-130.4](#).

**b. Apportionment Factor**

The numerator of a wholesale content distributor's receipts factor is the sum of its gross receipts from transactions and activity in the regular course of its trade or business within this State and the denominator is the sum of its gross receipts from transactions and activity in the regular course of its trade or business everywhere.

Receipts from transactions and activities in the regular course of business, including advertising, licensing, and distribution activities; and excluding receipts from the sale of real or tangible personal property, are in this State if received from a business “customer” that is domiciled in this State. Receipts from an individual “customer” are within this State if the individual’s billing address listed in the broadcaster’s books and records is in this State.

In no event may the amount of receipts sourced to North Carolina by a wholesale content distributor be less than the amount determined by multiplying two percent (2%) by the total domestic gross receipts of the wholesale content distributor from advertising and licensing activities.

#### 4. Bank Apportionment Factor ([G.S. § 105-130.4B](#))

##### a. Definitions

1. Bank – Defined in G.S. § [105-130.7B](#).
2. Billing address – The location indicated in the books and records of the taxpayer on the first day of the tax year, or on the date in the tax year when the customer relationship began, as the address where any notice, statement, or billing relating to the customer's account is mailed.
3. Borrower, cardholder, or payor located in this State – A borrower, credit cardholder, or payor whose billing address is in this State.
4. Card issuer's reimbursement fee – The fee a taxpayer receives from a merchant's bank because one of the persons to whom the taxpayer has issued a credit, debit, or similar type of card has charged merchandise or services to the card.
5. Credit card – A card, or other means of providing information, that entitles the holder to charge the cost of purchases, or a cash advance, against a line of credit.
6. Debit card – A card, or other means of providing information, that enables the holder to charge the cost of purchases, or a cash withdrawal, against the holder's bank account or a remaining balance on the card.
7. Loan – Any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such an extension of credit from another. The term includes participations, syndications, and leases treated as loans for federal income tax purposes.
8. Loan secured by real property – A loan or other obligation of which fifty percent (50%) or more of the aggregate value of the collateral used to secure the loan or other obligation, when valued at fair market value as of the time the original loan or obligation was incurred, was real property.
9. Merchant discount – The fee, or negotiated discount, charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit, debit, or similar type of card is accepted in payment for merchandise or services sold to the cardholder, net of any cardholder chargeback and unreduced by any interchange transaction or issuer reimbursement fee paid to another for charges or purchases made by its cardholder.
10. Participation – An extension of credit in which an undivided ownership interest is held on a prorated basis in a single loan or pool of loans and related collateral. In a loan participation, the credit originator initially makes the loan and then subsequently resells all or a portion of it to other lenders. The participation may or may not be known to the borrower.

11. Payor – The person who is legally responsible for making payment to the taxpayer.
12. Real property owned – Real property (i) on which the taxpayer may claim depreciation for federal income tax purposes or (ii) to which the taxpayer holds legal title and on which no other person may claim depreciation for federal income tax purposes or could claim depreciation if subject to federal income tax. Real property does not include coin, currency, or property acquired in lieu of or pursuant to a foreclosure.
13. Syndication – An extension of credit in which two or more persons fund and each person is at risk only up to a specified percentage of the total extension of credit or up to a specified dollar amount.
14. Tangible personal property owned – Tangible personal property (i) on which the taxpayer may claim depreciation for federal income tax purposes or (ii) to which the taxpayer holds legal title and on which no other person may claim depreciation for federal income tax purposes or could claim depreciation if subject to federal income tax. Tangible personal property does not include coin, currency, or property acquired in lieu of or pursuant to a foreclosure.
15. Transportation property – Vehicles and vessels capable of moving under their own power as well as any equipment or containers attached to such property. Examples of transportation property include aircraft, trains, water vessels, motor vehicles, rolling stock, barges, and trailers.

### **b. General Receipts**

The numerator of a bank's general receipts factor is the total receipts in this State during the tax year and the denominator is the total receipts everywhere during the tax year.

The same method is used in calculating receipts for the denominator as the numerator. The following are excluded from the receipts factor:

1. Receipts from a casual sale of property.
2. Receipts exempt from taxation.
3. The portion of receipts realized from the sale or maturity of securities or other obligations that represent a return of principal.
4. Receipts in the nature of dividends subtracted under G.S. §§ [105-130.5\(b\)\(3a\)](#) and [\(3b\)](#) and dividends excluded for federal tax purposes.
5. The portion of receipts from financial swaps and other similar financial derivatives that represent the notional principal amount that generate the cash flow traded in the swap agreement.

### **c. Receipts from the Sale, Lease, or Rental of Real Property**

Receipts from the sale, lease, or rental of real property are included in the numerator of a bank's apportionment factor if it is owned by the taxpayer and located in this State, or receipts from the sublease of real property if the property is located in this State.

**d. Receipts from the Sale, Lease, or Rental of Tangible Personal Property**

Unless it is transportation property, the numerator of a bank's apportionment factor includes receipts from the sale, lease, or rental of tangible personal property owned by the taxpayer if the property is located in this State when it is first placed in service by the lessee.

If the tangible personal property is transportation property owned by the taxpayer, receipts from its lease or rental are included in the numerator to the extent that the property is used in this State. Aircraft will be considered used in this State and receipts included in the numerator as determined by the multiplication of all receipts from the lease or rental of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this State and the denominator of which is the total number of landings of the aircraft. If the extent of use of any transportation property in this State cannot be determined, then the property will be considered to be used wholly in the state where it has its principal base of operations. A motor vehicle will be considered wholly used in the state in which it is registered.

**e. Receipts from Interest, Fees, and Penalties from Loans Secured by Real Property**

Receipts from interest, fees, and penalties from loans secured by the real property are included in the numerator of a bank's apportionment factor if the borrower is located in this State. If the property is both located in this State and one or more other states, the receipts are included if more than 50% of the fair market value of the real property is located in this State. If more than 50% of the fair market value is not located within any one state, then the receipts are included in the numerator if the borrower is located in this State. The determination of if the real property securing a loan is located in this State is made as of the time the original agreement was made and any and all subsequent substitutions of collateral are disregarded.

**f. Receipts from Interest, Fees, and Penalties from Loans Not Secured by Real Property**

The numerator of a bank's apportionment factor includes interest, fees, and penalties from loans not secured by real property if the borrower is located in this State.

**g. Receipts from Net Gains from the Sale of Loans**

The numerator of a bank's apportionment factor includes net gains from the sale of loans. Such net gains include income recorded under the coupon stripping rules of section 1286 of the Code. The amount of net gains from the sale of loans included in the numerator is determined as follows:

1. Secured by real property – The amount of net gains, not less than zero, from the sale of loans secured by real property is determined by multiplying the net gains by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to the special rule for "interest, fees, and penalties from loans secured by real

property” (see above), and the denominator of which is the total amount of interest, fees, and penalties from loans secured by real property. The amount of net gains cannot be less than zero.

2. Not secured by real property – The amount of net gains, not less than zero, from the sale of loans not secured by real property is determined by multiplying the net gains by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to the special rule for “interest, fees, and penalties from loans not secured by real property” (see above), and the denominator of which is the total amount of interest, fees, and penalties from loans not secured by real property.

**h. Receipts from Interest, Fees, and Penalties from Cardholders**

The numerator of a bank’s apportionment factor includes interest, fees, and penalties charged to credit, debit, or similar cardholders, including annual fees and overdraft fees, if the cardholder is located in this State.

**i. Receipts from ATM fees**

The numerator of a bank’s apportionment factor includes receipts from fees from the use of an ATM owned or rented by the taxpayer, if the ATM is located in this State. All ATM fees not forwarded directly to another bank are included. Receipts from ATM fees not sourced under the special rule for “receipts from ATM fees” are sourced as “all other receipts”.

**j. Receipts from Net Gains from the Sale of Credit Card Receivables**

The numerator of a bank’s apportionment factor includes net gains, not less than zero, from the sale of credit card receivables multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to the subsection (h) for “receipts from interest, fees, and penalties from cardholders,” and the denominator of which is the taxpayer’s total amount of interest, fees, and penalties charged to cardholders.

**k. Miscellaneous Receipts**

The numerator of the apportionment factor includes all of the following:

- a. Card issuer's reimbursement fees – Receipts from card issuer's reimbursement fees if the payor is located in this State.
- b. Receipts from merchant's discount – Receipts from a merchant discount if the payor is located in this State.
- c. Loan servicing fees – Receipts from loan servicing fees if the payor is located in this State.
- d. Receipts from services – Receipts from services not otherwise apportioned under this section if the payor is located in this State.

- e. Receipts from investment assets and activity and trading assets and activity include receipts from one or more of the following:
  - i. Interest and dividends from investment assets and activities and trading assets and activities if the payor is located in this State.
  - ii. Net gains and other income, not less than zero, from investment assets and activities and trading assets and activities multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor of interest and dividends from investment assets and activities and trading assets and activities if the payor is located in this State, and the denominator of which is the taxpayer's total amount of interest and dividends from investment assets and activities and trading assets and activities.

## **I. All Other Receipts**

Any other receipts not specifically addressed by a special rule are included in the numerator of a bank's apportionment factor if the payor is located in this State.

## **5. State Net Loss Apportionment Election (G.S. § [105-130.4\(t3\)](#))**

A State net loss “balance” is defined as the total amount of State net losses computed under G.S. § [105-130.8A](#) for tax years beginning before January 1, 2020, and available to carry forward to tax years beginning on or after January 1, 2020. The balance cannot include a loss created in a tax year beginning on or after January 1, 2020. If created on or after January 1, 2020, the State net loss must be determined using the apportionment for market-based sourcing as set forth in G.S. § [105-130.4\(l\)](#).

## **K. Deduction of Contributions (G.S. § [105-130.9](#))**

### **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 in section 170(c) of the Internal Revenue Code.

### **3. Contributions Limited to Five Percent (5%) of Net Income**

The deduction for contributions made to qualified organizations, other than those discussed in section 4 below, are limited to five percent (5%) of the corporation's net income as determined before the deductions for contributions. Excess contributions cannot be carried over for use in subsequent years.

### **4. Contributions Fully Deductible**

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 includes 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 (or State net 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 (or State net 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>
	\$ 185
Net taxable income	\$ 515

## 5. Contributions by Corporations Allocating Net Income

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 (or State net 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 (or State net loss) deduction	<u>6,000</u>
 Total income allocated to NC 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>
	\$ 1,700
 Net taxable income	\$ 28,300

## **L. Rapid Amortization of Equipment Mandated by OSHA (G.S. § [105-130.10A](#))**

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.

## **M. Amortization of Bond Premiums (G.S. § [105-130.5](#))**

### **1. Preliminary Statement ([17 NCAC 05C.1401](#))**

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 ([17 NCAC 05C.1402](#))**

The amount of premium paid upon the purchase of a tax-exempt bond is amortized over the life of the bond. Amortization for the tax 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>	
		\$5,060
Gain		\$ 40

### 3. Taxable Bonds ([17 NCAC 05C.1403](#))

A portion of the premium paid upon the purchase of a taxable bond may be deducted in the tax 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>	
		\$12,250
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	<u>\$12,500</u> (\$ 125)

#### 4. **Definition of Bond ([17 NCAC 05C.1404](#))**

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.

### N. **Net Economic Loss Carry-Over (G.S. § 105-130.8)**

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

For tax years beginning *before* January 1, 2015, North Carolina allows a carry forward of a net economic loss for a period of fifteen (15) years. A net economic loss carried forward from any year is first 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.

For information on loss treatment for tax years beginning on or after January 1, 2015, *see Section O. State Net Loss.*

#### 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:

- a. For North Carolina tax purposes, the loss must be a net *economic* loss rather than a net *operating* loss.
- b. 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. **Net Economic Loss**

##### a. **Net Economic Loss Definition**

A net economic loss for any year means the amount by which allowable deductions, other than prior years' losses, exceeds income from all sources in the year including any income not taxable under Article 4, Part 1 of the North Carolina Revenue Act. *Dayco Corporation v. Clayton*, Commissioner of Revenue (1967), 269 N.C. 490,153 S.E. 2nd 28.

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

A net economic loss from a prior year may be 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*.)

**c. Substantiation**

Taxpayers must maintain and make available for inspection all records necessary to determine and verify the amount of State net loss deduction. In addition, the Department or the taxpayer may redetermine a loss in a year that is closed under the statute of limitations to adjust the amount that may be carried forward in an open tax year.

**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. Corporations Allocating and Apportioning 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 apportioned part of such determined net economic loss deduction is deducted from the total amount of income allocated and apportioned to this State. For example, a corporation apportioning 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 apportioning 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 apportionment percentage applicable to the succeeding year.

**6. 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, 251 N.C. 120, 110 S.E.2d 880 (1959); *Holly Farms Poultry Industries, Inc. v. Clayton*, Commissioner of Revenue, 9 N.C. App. 345, 176 S.E.2d 367 (1970); *Fieldcrest Mills, Inc. v. Coble*, 290 N.C. 504, 135 S.E.2d 205 (1976); *Bellsouth Telecommunications, Inc., d/b/a Southern Bell Telephone and Telegraph Company v. Department of Revenue*, 485 S.E.2d 333 (1997).

## 7. Example

The following example shows the proper method of computing net economic losses and the correct procedure for carrying them forward as deductions. For the federal and NC returns used in this example, see:

<https://www.ncdot.gov/documents/important-notice-computation-net-economic-loss-north-carolina-gen-stat-105-1308>

ABC Loss Co (“ABC”) is a North Carolina corporation engaged in the business of manufacturing chemicals within and without this State. ABC’s business is not directed or managed from its North Carolina offices; ABC’s commercial domicile is not in this State. For 2013, ABC filed a federal form 1120, showing a taxable loss of \$199,000.

In determining the federal taxable loss for years 2013, the corporation includes the following income and deduction items:

- a. Dividend income from more than 20% owned corporations in the amount of \$3,050,000.
- b. Dividend income from affiliated group members in the amount of \$1,808,000.
- c. Dividend income from foreign corporations in the amount of \$1,043,000.
- d. U.S. Government interest income in the amount of \$26,000.
- e. Other income in the amount of \$10,000,000.
- f. Other deductions in the amount of \$11,878,000.
- g. A special deduction in the amount of \$4,248,000.

In determining State net income, the corporation makes the following adjustments to its federal taxable loss:

- a. Deducts U.S. Government interest in the amount of \$26,000.
- b. Deducts dividend income from foreign corporations in the amount of \$1,043,000.

In addition, the corporation classifies dividend income in the amount of \$610,000 as nonapportionable income. The amount of nonapportionable dividend income is calculated by reducing the amount of dividend income reported in 2010 (\$5,901,000) by the sum of the special deduction (\$4,248,000) and the dividend income from foreign corporations (\$1,043,000).

During tax year 2013, the corporation received life insurance proceeds in the amount of \$50,000 as a result of the death of an employee and the proceeds were excluded from federal taxable income.

For tax year 2013, the North Carolina apportionment factor is sixty percent (60%).

### **Computation of Corporate Income Tax for 2013**

Federal Taxable Income	(199,000)
<b>Adjustments to Federal Taxable Income</b>	
Deduct: U.S. Government Interest	26,000
Deduct: Foreign Dividends	1,043,000
	1,069,000
N.C. Taxable Income	(1,268,000)
<b>Nonapportionable Income</b>	
Deduct: Dividend Income Classified as Nonapportionable	610,000
Apportionable Income	(1,878,000)
Apportionment Factor	60.0000%
Income Apportionable to N.C.	(1,126,800)
Nonapportionable Income Allocated Directly to NC	0
Income Subject to N.C. Tax for 2013	(1,126,800)

### Computation of Net Economic Loss for 2013

Apportionable Income	(1,878,000)
Income sources received in 2013 not taxable in North Carolina:	
Add: Life insurance proceeds	50,000
Add: Nonapportionable dividend income	<u>610,000</u>
	<u>660,000</u>
<b>Net economic loss for tax year 2013</b>	(1,218.800)
Apportionment Factor	60.0000%
<b>Net economic loss apportioned to N.C. for tax year 2013</b>	<b>(730,800)</b>

For 2014, the corporation's federal taxable loss is \$772,500.

In determining the federal taxable loss for tax year 2014, the corporation includes the following income and deduction items:

- a. Dividend income from more than 20% owned corporations in the amount of \$4,050,000.
- b. Dividend income from affiliated group members in the amount of \$1,808,000.
- c. U.S. Government interest income in the amount of \$6,000.
- d. Other income in the amount of \$5,000,000.
- e. Other deductions in the amount of \$6,588,500.
- f. A special deduction in the amount of \$5,048,000.

In determining State net income, the corporation deducts U.S. Government interests in the amount of \$6,000. The corporation also classifies dividend income in the amount of \$810,000 as nonapportionable income. The amount of nonapportionable dividend income (\$810,000) is calculated by reducing the amount of dividend income reported in 2011 (\$5,858,000) by the amount of special deduction (\$5,048,000).

For tax year 2014, the North Carolina apportionment factor is seventy percent (70%).

In addition in tax year 2014, the corporation received interest income from municipal bonds in the amount of \$100,000 that was not taxed for federal or State income tax purposes.

### **Computation of Corporate Income Tax for 2014**

Federal Taxable Income	(772,500)
Adjustments to Federal Taxable Income	
Deduct: U.S. Government Interest	6,000
N.C. Taxable Income	(778,500)
Nonapportionable Income	
Deduct: Dividend Income Classified as Nonapportionable	810,000
Apportionable Income	(1,588,500)
Apportionment Factor	70.0000%
Income Apportionable to N.C.	(1,111,950)
Nonapportionable Income Allocated Directly to NC	0
Income Subject to N.C. Tax for 2014	(1,111,950)

### **Computation of Net Economic Loss for 2014**

Apportionable Income	(1,588,500)
Income sources received in 2014 not taxable in North Carolina:	
Add: Nonapportionable dividend income	810,000
Add: Municipal bond interest income	<u>100,000</u>
	<u>910,000</u>
<b>Net economic loss for tax year 2014</b>	<b>(678,500)</b>
Apportionment Factor	70.0000%
<b>Net economic loss apportioned to N.C. for tax year 2014</b>	<b>(474,950)</b>

## **Computation of Net Economic Deduction**

Net economic loss apportioned to North Carolina for tax year 2013 (730,800)

Income received in 2014 not taxable in North Carolina:

Dividend received deduction (70% of 5,048,000)	3,533,600
U.S. Government interest (70% of 6,000)	4,200
Nonapportionable dividend income (70% of 810,000)	567,000
Municipal bond interest income (70% of 100,000)	<u>70,000</u> <u>4,174,800</u>

**Net economic loss deduction** **0\*\***

\*\*(No net economic loss deduction exists from net economic loss created in 2013 because the net economic loss apportioned to North Carolina for tax year 2013 does not exceed the amount of income not taxable in North Carolina received in 2014. Therefore, the only net economic loss available to be carried forward to tax year 2015 is the net economic loss created in 2014, which is 474,950.)

## **O. State Net Loss Deduction (G.S. § [105-130.8A](#))**

### **1. Preliminary Statement**

For tax years beginning *on or after* January 1, 2015, corporate taxpayers will no longer use a net economic loss calculation under G.S. § [105-130.8](#), but rather will use a State net loss calculation that is more comparable to the federal net operating loss deduction.

### **2. State Net Loss**

- a. A State net loss for a tax year means the amount by which allowable deductions (not including any prior year losses) exceed gross income under the Code as adjusted under G.S. § [105-130.5](#). For taxpayers that have income from business activities within and without North Carolina, the loss must be allocated and apportioned pursuant to G.S. § [105-130.4](#).
- b. A taxpayer may carry forward a State net loss from a prior tax year and deduct the amount in the current tax year, subject to the following limitations:
  - i. The loss must have been created in one of the preceding fifteen (15) tax years;
  - ii. Any loss carried forward must be applied first to the immediately succeeding tax year before any portion may be carried forward to a subsequent tax year; and
  - iii. In the case of a merger or acquisition of a loss corporation occurring on or after January 1, 2015, the standards contained in Treasury Regulations under sections 381 and 382 of the Code are applied on a separate entity basis to determine the amount of losses that survive for North Carolina purposes. In the case of a merger

or acquisition of a loss corporation occurring prior to tax years beginning January 1, 2015, where a net economic loss survived but was limited under G.S. § 105-130.8, the surviving loss is now evaluated under sections 381 and 382 of the Code for tax years beginning on or after January 1, 2015.

- c. Taxpayers must maintain and make available for inspection all records necessary to determine and verify the amount of State net loss deduction. In addition, the Department or the taxpayer may redetermine a loss in a year that is closed under the statute of limitations to adjust the amount that may be carried forward in an open tax year.

### **3. Corporations Allocating and Apportioning Their Net Income**

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 State net loss. The apportioned part of State net loss deduction is deducted from the total amount of income allocated and apportioned to this State. For example, a corporation apportioning fifty percent (50%) of its net income or loss to North Carolina in a particular year in which it sustains a total State net loss of one thousand dollars (\$1,000) may carry forward only five hundred dollars (\$500) to a subsequent year.

Where the apportioning 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 apportionment percentage applicable to the succeeding year.

### **4. Coordination with Net Economic Loss Provisions**

Beginning January 1, 2015, unused net economic losses become a static amount. In addition, as of January 1, 2015, any unused portion of a net economic loss carried forward will not have to be offset by nontaxable income.

### **5. Coordination with Law Change to Market-Based Sourcing of Receipts (Effective for tax years beginning on or after January 1, 2020, G.S. § [105-130.4\(t3\)](#))**

Corporate taxpayers that have a “State net loss balance” as of the end of the 2019 tax year may elect to apportion receipts from services based on the percentage of its income-producing activities performed in this State on their 2020 tax return. This election is binding and irrevocable until the tax year in which the existing State net loss balance is fully utilized or has expired, whichever is earlier.

A “State net loss balance” is defined as the total amount of State net losses computed under G.S. § 105-130.8A for tax years beginning before January 1, 2020, and available to carry forward to tax years beginning on or after January 1, 2020. The balance does not include a loss created in a tax year beginning on or after January 1, 2020. Losses created on or after January 1, 2020, are determined using the apportionment for market-based sourcing in G.S. § 105-130.4(l).

## 6. Example

The following example shows the proper method of computing a State net loss and the application of G.S. § [105-130.8A](#).

The facts are the same as the Example in Item 7, except ABC's income item amounts and losses occur in tax years 2014 and 2015, respectively, as follows:

### Computation of Corporate Income Tax for 2014

Federal Taxable Income	(199,000)
<b>Adjustments to Federal Taxable Income</b>	
Deduct: U.S. Government Interest	26,000
Deduct: Foreign Dividends	1,043,000
N.C. Taxable Income	(1,268,000)
<b>Nonapportionable Income</b>	
Deduct: Dividend Income Classified as Nonapportionable	610,000
Apportionable Income	(1,878,000)
Apportionment Factor	60.0000%
Income Apportionable to N.C.	(1,126,800)
Nonapportionable Income Allocated Directly to NC	0
Income Subject to N.C. Tax for 2014	(1,126,800)

### Computation of Net Economic Loss for 2014

Apportionable Income	(1,878,000)
Income sources received in 2014 not taxable in North Carolina:	
Add: Life insurance proceeds	50,000
Add: Nonapportionable dividend income	<u>610,000</u>
Net economic loss for tax year 2014	(1,218,800)
Apportionment Factor	60.0000%
<b>Net economic loss apportioned to N.C. for tax year 2014</b>	<b>(730,800)</b>

### Computation of Corporate Income Tax for 2015

Federal Taxable Income	(772,500)
Adjustments to Federal Taxable Income	
Deduct: U.S. Government Interest	6,000
N.C. Taxable Income	(778,500)
Nonapportionable Income	
Deduct: Dividend Income Classified as Nonapportionable	810,000
Apportionable Income	(1,588,500)
Apportionment Factor	70.0000%
Income Apportionable to N.C.	(1,111,950)
Nonapportionable Income Allocated Directly to NC	0
Income Subject to N.C. Tax	(1,111,950)
<b>State net loss for tax year 2015</b>	<b>(1,111,950)</b>
<b>**Net economic loss deduction from 2014</b>	<b>(730,800)</b>
<b>State net taxable income and state net loss carryover</b>	<b>(1,842,750)</b>

\*\*Beginning on or after January 1, 2015, a net economic loss carried forward from a prior year becomes a static amount, and as of January 1, 2015, will not have to be first offset by nontaxable income in that year or any future years.

**P. Secretary's Authority to Adjust Net Income or Require a Combined Return (G.S. § 105-130.5A)**

**1. Preliminary Statement**

When the Secretary has reason to believe that any corporation conducts its business in such a manner as to fail to accurately report its State net income properly attributable to its business carried on in this State through the use of intercompany transactions that lack economic substance or are not at fair market value, the Secretary may request in writing that the corporation provide any information reasonably necessary to substantiate the economic substance and appropriate fair market value of the corporation's intercompany transactions. A corporation must provide the requested information within ninety (90) days of the request.

If a corporation fails to timely provide the requested information, the Secretary may propose any adjustment allowable under Part 1 of Article 4, Corporation Income Tax. See G.S. § 105-251(a).

## 2. Definitions (G.S. § [105-130.5A\(i\)](#) and [17 NCAC 05F.0102](#))

As used in G.S. § [105-130.5A](#), the following definitions apply:

- a. Affiliated group** is two or more corporations or noncorporate entities in which more than fifty percent (50%) of the voting stock or membership interest is controlled by a common owner or owners.
- b. Centralized cash management** means a process that an affiliated group of businesses makes most or all cash management decisions from one location (e.g., headquarters or designated subsidiary) with individual subsidiaries having little authority over cash management decisions.
- c. Economic position** means the status of a taxpayer's assets, liabilities, and equity (whether actual, contingent, or potential) and the interrelationships to one another.
- d. Material benefit** means an improvement in the economic position of the taxpayer on a pre-tax basis.
- e. Material business activity** means an activity that is an integral part of the unitary group's business **and** performed on a regular and continuous basis.
- f. Principal member** means a member of the combined group that acts in the group's name for all income tax liability matters of the combined group and is responsible for preparing and making income tax payments for the combined group.
- g. Unitary business** means one or more related business organizations where there is a unity of ownership, operation and use. A unitary business can also exist when there is interdependence in functions. The determination of entities comprising a unitary business is determined based on the facts and circumstances in each case.

## 3. Adjustment of Net Income (G.S. § [105-130.5A\(b\)](#) and [17 NCAC 05F.0401](#))

After the requested information has been provided by the corporation, if the Secretary finds as a fact that a corporation's intercompany transactions lack economic substance or are not at fair market value, the Secretary may redetermine State net income properly attributable to the business carried on in the State. The adjustments the Secretary may make include:

- a) disallowing deductions in whole or part;
- b) attributing income to related corporations;
- c) disregarding transactions; or
- d) reclassifying income as apportionable or allocable.

If such adjustments are not adequate under the circumstances to redetermine State net income, the Secretary can require the corporation to file a return that reflects the State net income on a combined basis of all members of its affiliated group that are conducting a unitary business.

#### **4. Combined Returns**

Under State law, a corporation is not permitted to voluntarily file a consolidated or combined income tax return. However, if the Secretary finds as a fact that a combined return is required, the Secretary will notify the corporation in writing to submit a combined return. The corporation must submit the combined return within ninety (90) days of the written notice. The submission of the combined return does not constitute an agreement that the assessment based on the combined return is correct or that additional tax is due.

If the Secretary requires a combined return, the combined State net income of the corporation and all members of the affiliated group included in the combined return are computed in accordance with G.S. § [105-130.4](#). The methodology and procedures for preparing a combined income tax return, when requested or permitted by the Secretary, are listed in North Carolina Administrative Code [17 NCAC 05F.0501](#), [17 NCAC 05F.0502](#) and [17 NCAC 05F.0503](#).

If the Secretary requires a combined return, the return shall include all members of the corporation's affiliated group that are conducting a unitary business, regardless of whether each member is independently doing business in this State. The Secretary or the corporation may propose a combination of fewer than all members of a unitary group. However, the Secretary cannot require a combination of less than all members of the unitary group without the corporation's consent.

#### **5. Statement of Findings**

If the Secretary makes an adjustment to net income or requires a combined return under the authority of G.S. § [105-130.5A](#), the Secretary must provide the corporation a written statement detailing the facts, circumstances and reasons for the adjustment and the proposed method of computing the corporation's State net income. The statement must be provided within ninety (90) days of a proposed assessment made under this section.

#### **6. Economic Substance (G.S. § [105-130.5A\(g\)](#), [17 NCAC 05F.0201](#) and [17 NCAC 05F.0202](#))**

An intercompany transaction has economic substance if (i) the transaction, or the series of transactions of which the transaction is a part, has one or more reasonable business purposes other than State income tax benefits; and (ii) the transaction, or the series of transactions of which the transaction is a part, has economic effects beyond the creation of State income tax benefits.

The taxpayer has the burden of proving that a transaction meets both prongs of the economic substance test as specified in G.S. § [105-130.5A\(g\)](#). To prove a transaction, or series of transactions of which the transaction is a part, has a reasonable business purpose other than State income tax benefits, the taxpayer must show that:

- a. The business purpose asserted was valid and realistic;
- b. The transaction was a reasonable and realistic means to accomplish the asserted business purpose;
- c. Evidence exists showing the taxpayer took steps to achieve the asserted business purpose; and
- d. The value of the non-State income tax benefits reasonably anticipated from the transaction exceeds the additional cost associated with the transaction.

In general, contemporaneous documentation supports the assertion of a reasonable business purpose. Although not conclusive, a lack of contemporaneous documentation weakens the contention that the asserted business purpose is valid.

## **7. Economic Effects ([17 NCAC 05F.0203](#))**

In proving that a transaction, or a series of transactions of which the transaction is a part, has economic effects other than State income tax benefits, the taxpayer must show by objective evidence that a reasonable likelihood existed at the time the transaction was initiated that there was material benefit of the transaction other than State income tax benefits.

## **8. Economic Substance Doctrine ([17 NCAC 05F.0204](#))**

The Secretary will rely on general principles developed from federal and state tax law cases in applying each prong of the two pronged test under G.S. § [105-130-5A\(g\)](#), except where case law conflicts with the statute. General principles of the economic substance doctrine include:

- a. Economic substance is a prerequisite to any provision allowing deductions;
- b. The taxpayer has the burden of proving a transaction has both purpose and substance;
- c. The taxpayer has the burden of showing that the form of the transaction accurately reflects its substance and that the deductions claimed are permissible;
- d. The economic substance of the transaction is determined based on documentation and data, not the subjective opinions of the taxpayer; and
- e. The transactions, not the entities, will be examined for economic substance.

## 9. Economic Substance Factors ([17 NCAC 05F.0205](#))

In determining whether a transaction has economic substance, *all* the following apply:

- a. Reasonable business purpose which includes any material benefit other than State income tax benefits.
- b. Whether the transaction has effects beyond the creation of State income tax benefits may be satisfied by demonstrating material business activity of the entities involved in the transaction. Material business activity will be evaluated in light of and with respect to the type of transactions under review.
- c. If the State income tax benefits achieved by the transaction (or series of transactions which transaction is a part) are consistent with legislative intent, such intent is considered in determining whether the transaction has business purpose and economic substance. Examples of legislative intent include a purpose statement directly in the law or explanation in the administrative code.
- d. Centralized cash management of an affiliated group is not evidence of a lack of economic substance.
- e. Achieving a financial accounting benefit will not be considered as a reasonable business purpose for a transaction if the origin of such benefit is a reduction of State income tax.

The taxpayer has the burden of proof in demonstrating the transaction meets both tests of the economic substance doctrine. The Secretary shall consider all the facts and circumstances in evaluating whether economic substance has been met, including:

- a. The reasons for the transaction and whether the transaction was a reasonable means to accomplish the asserted purposes;
- b. Expectations of benefits obtained from the transactions;
- c. The effects the transaction had on the taxpayer's profits;
- d. The existence of a reasonable or realistic potential for profit;
- e. The objective economic impact of the transaction other than State income tax savings;
- f. The transaction's effect on the taxpayer's State income tax liability, tax liability in other states, and federal tax liability;
- g. Whether the method of determining the amount of payment is an industry practice;
- h. The change in the business operations of the parties, if any, after the transaction;

- i. Whether assets were transferred between or among related parties, the business operations related to specific assets changed after any transfer, whether the transferor retained control over the assets, and the tax consequences;
- j. The party or parties who created or developed and presented the ideas which led to the transaction;
- k. Whether the contemporaneous documentation explaining the transaction to the taxpayer discussed profit potential in addition to tax benefits;
- l. The party or parties that drafted, negotiated, or dictated the terms of the agreement relating to the transaction;
- m. Cost-benefit analyses or other studies conducted;
- n. Non-tax benefits obtained by the taxpayer as a result of the transaction; and
- o. Whether the intercompany transaction resulted in a circular cash flow.

## **10. When State Income Tax Benefits are Considered ([17 NCAC 05F.0206](#))**

State income tax benefits from a transaction are considered by the Secretary in determining whether a transaction has a reasonable business purpose and economic substance when the benefits are consistent with legislative intent, such as when a transaction is in accordance with laws enacted to encourage certain types of activities through tax deductions or credits.

When a transaction generated targeted tax incentives is, in form and substance, consistent with State income tax benefits designed by the General Assembly, the State income tax benefits will be considered by the Secretary in determining whether the transaction has a reasonable business purpose and economic substance.

## **11. Centralized Cash Management ([17 NCAC 05F.0207](#))**

The existence of a centralized cash management system among affiliated group members is not conclusive evidence that a transaction lacks economic substance; however, the Secretary will analyze the transactions for a reasonable business purpose and economic substance.

If a cash management transaction, or series of transactions of which the transaction is a part, creates unreasonably excessive interest expense when compared to industry practice, a shifting of assets, or reclassification of income as nonapportionable or nonallocable, the transaction may be deemed to lack economic substance.

## **12. Determination of Fair Market Value ([17 NCAC 05F.0301](#))**

For purposes of determining whether transactions between members of an affiliated group are at fair market value, the standards contained in the regulations under section 482 of the Code will be used. Treas. Reg. § 1.482-1 sets out the principle that the primary purpose of section 482 is to prevent the avoidance of taxes. Thus, in general, transactions between

related entities should be consistent with the result that would occur between unrelated parties. The regulations provide various methodologies that may be used to determine a correct arm's-length rate; however, no best method for evaluating transactions is provided. For North Carolina purposes, the nature of the transactions and potential avoidance of State net income taxes as well as the potential circumvention of G.S. § [105-130.7A](#) or other corporate tax statutes will be considered in selecting the best methodology.

The Secretary's authority to make other adjustments is not limited by G.S. § [105-130.5A](#) except the adjustments cannot limit a corporation's option for reporting royalty payments pursuant to G.S. § [105-130.7A](#). Thus, a methodology that allows for the use of copyright, patent or trademark either without charge or without a separately stated amount is therefore generally inconsistent with the arm's-length standard of section 482 and the option for reporting royalty payments pursuant to G.S. § [105-130.7A](#). In these cases, the Secretary may separately request or determine the arm's-length royalty rate to comply with G.S. §§ [105-130.5A\(o\)](#) and [105-130.7A](#).

The Secretary will consider all the facts and circumstances in determining fair market value including federal and state case law with respect to section 482 of the Code. A transfer pricing study submitted by a taxpayer will also be considered, but will not, by itself, establish that the transaction is at fair market value.

### **13. Entities Excluded from a Combined Return**

The following entities are excluded from a combined return:

- a. A corporation not required to file a federal income tax return.
- b. An insurance company (except for a captive insurance company) that is:
  - (i) Subject to tax under Article 8B of Chapter 105;
  - (ii) Subject to tax under Article 21 of Chapter 58 or similar tax in another state;
  - (iii) Licensed as a reinsurance company;
  - (iv) A life insurance company under section 816 of the Code; or
  - (v) An insurance company subject to tax under section 831 of the code.

“Captive insurance company” means an insurer that is part of an affiliated group that receives more than fifty percent (50%) of net written premiums or amounts received as compensation for insurance from affiliated group members.

- c. A tax exempt corporation under section 501 of the Code.
- d. An S corporation.

- e. A foreign corporation under Code section 7701, other than a domestic branch of such corporation.
- f. A partnership, LLC, or other entity not taxed as a corporation.
- g. A corporation with eighty percent (80%) or more of gross income from all sources deemed foreign business income under Code section 861(c)(1)(B) in effect July 1, 2009.

## **14. Proposed Assessments or Refunds, Extensions and Penalties, and Appeals**

- a. Proposed Assessments or Refunds** – The Secretary will issue a proposed assessment or refund if a redetermination of State net income is made under the provisions of G.S. § [105-130.5A](#). However, if a refund is determined wholly or partially by a proposed assessment to an affiliated group member, the refund will not be issued until the proposed assessment to the affiliated group member has become collectible under G.S. § 105-241.22. The refund amount will reflect any changes made by the Department. Otherwise, the procedures in Article 9 of Chapter 105 will apply to any such assessment or refund.
- b. Extensions and Penalties** - The Secretary and the taxpayer may extend any time limit in this section by mutual agreement. If a combined return is not timely submitted after requested, the corporation is subject to the penalties of G.S. § [105-236\(a\)\(3\)](#). Penalties will not be imposed except as provided in this section and G.S. § [105-236\(a\)\(5\)f](#).
- c. Appeals** – The Office of Administrative Hearings will review de novo a final determination by the Secretary under G.S. § [105-130.5A](#). This review will evaluate whether (i) the taxpayer's separate return fails to properly report State net income as a result of intercompany transactions due to a lack of economic substance or fair market value of the transactions; (ii) the Secretary's method of determining State net income is appropriate; and (iii) if a combined return was determined to be required, whether other adjustments rather than a combined return are adequate to correctly reflect State net income.

## **15. Voluntary Redetermination**

If the Secretary believes that because of intercompany transactions, a corporation's State net income is not accurately reported on a separate return, without making a finding that those transactions lack economic substance or are not at fair market value, the Secretary and corporation may jointly agree to an alternative filing methodology to accurately reflect State net income. The Secretary is authorized to allow any reasonable method for these purposes.

## **16. Procedures for Requesting a Redetermination Private Letter Ruling to File a Combined Tax Return (G.S. § [105-130.5A\(m\)](#))**

A corporation cannot voluntarily file a combined income tax return. However, a taxpayer may request in writing a redetermination private letter ruling (Form NC-481), which is written advice issued by the Secretary to a taxpayer regarding whether a redetermination of a corporation's State net income or a combined return would be required by the Secretary.

There is a \$5,000 fee for a redetermination private letter ruling. Due to the complexity of the facts and circumstances, the Department cannot accept a taxpayer's request for an expedited redetermination private letter ruling.

For more information regarding how to request a redetermination private letter ruling, see:

[https://files.nc.gov/ncdor/documents/files/written\\_determinations\\_and\\_letters\\_of\\_general\\_applicability.pdf](https://files.nc.gov/ncdor/documents/files/written_determinations_and_letters_of_general_applicability.pdf)

## **17. Franchise Tax**

Any corporation included in a combined income tax return doing business in this State under G.S. § [105-114\(b\)\(3\)](#) must file a separate franchise tax return for each tax period. The assets, liabilities, income, deductions or credits of the corporation cannot be combined for this purpose. A franchise tax return is required even if only the minimum franchise tax is due.

Any corporation included in a combined income tax return but is not doing business in this State under G.S. § [105-114\(b\)\(3\)](#) is not subject to franchise tax.

The principal member files its franchise tax return on the combined group's CD-405. All other combined group members must file a separate CD-405 and compute its separate franchise tax, if required, include \$0 on the "Net Taxable Income" and "NC Net Income Tax" lines of the CD-405, and attach a statement with the return that (i) indicates its income is included on a combined return filed by a principal member; and (ii) identifies the name and federal EIN number of the principal member.

If the corporation filing the franchise tax return is a multistate taxpayer, then the apportionment factor used in determining the Net Worth base is calculated using its separate entity sales, before intercompany eliminations. Schedule O of the CD-405 must reflect the entity's apportionment factor for franchise tax purposes.

## **Q. [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 includes its proportionate share of the partnership's 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](#).

## **R. 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 fourth month following the close of the income year and are filed on a combination return form. 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 one hundred five (105) days following the last day of the short period.

A corporation organized outside the United States 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 seventh month following the close of its income year.

Returns of agricultural cooperatives are due on or before the 15th 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 August 15 (one hundred five (105) days after April 30.) On August 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 August 15.

*Example 2:* The short tax period for Corporation Y ends on May 16. The short period return and tax payment are due on September 15 (one hundred five (105) days after May 31). On September 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 September 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**

A corporation subject to the corporate income tax may obtain an extension of time for filing its income tax return. For tax years beginning on or after January 1, 2008, and before January 1, 2025, the extension of time is six (6) months from the original due date of the return. For tax years beginning on or after January 1, 2025, the extension of time is seven (7) months from the original due date of the return.

A corporation that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina franchise and income tax return. To receive an automatic State extension, the corporation must certify on the North Carolina tax return that the corporation was granted an automatic federal extension. The automatic extension only applies to extension applications filed by a corporation with the Commissioner of Internal Revenue. The automatic extension does not apply to extensions granted under section 7508A of the Code because of a presidentially declared disaster.

A corporation that is not granted an automatic extension to file a federal income tax return must file Form CD-419 by the original due date of the return to receive an extension for North Carolina franchise and income tax purposes. Form CD-419 is available at:

<https://www.ncdor.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

An extension of time for filing a franchise and corporate income tax return does not extend the time for paying the tax due or the time when a penalty attaches for failure to pay the tax.

For additional detailed information concerning the requirements for obtaining an extension of time for filing a corporate franchise and income tax return, see the Department's website at:

<https://www.ncdor.gov/taxes/corporate-income-franchise-tax/extensions>

## **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. For information on paying electronically, see:

<https://www.ncdor.gov/file-pay/eservices>

#### **4. Interest and Penalties**

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. Corporations are also subject to the penalties levied pursuant to G.S. § [105-236](#).

#### **5. 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 tax 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 tax 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**

###### **i. 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.ncdor.gov](http://www.ncdor.gov).

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.*

###### **ii. When Due**

Declaration returns and payments of tax are due to be filed on or before the 15th day of the 4th, 6th, 9th and 12th months of the tax 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 i or ii below.)

- i. It amounts to as much as the tax paid on the return of the preceding tax year of twelve (12) months.
- ii. 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.
- iii. It amounts to ninety percent (90%) of the tax shown on the current annual income tax return.
- iv. 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 Tax 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\(d\)](#), [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:

- i. The corporation is required under the Internal Revenue Code to pay its federal estimated corporate income tax by electronic funds transfer.
- ii. The corporation has paid estimated corporate income tax installments of two hundred forty thousand dollars (\$240,000) or more in a twelve-month period (the average amount being twenty thousand dollars (\$20,000) per month). 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.

## **6. Contribution of Income Tax Refund to North Carolina Wildlife Fund**

Corporations may elect to contribute part or all of its overpayment to the North Carolina Nongame and Endangered Wildlife Fund on the specified line of the corporate income tax return. The election to contribute to the Fund cannot be changed after the return is filed.

If the corporation is not due a refund, it may still contribute to this Fund by mailing your donation directly to the:

North Carolina Wildlife Resources Commission  
1702 Mail Service Center  
Raleigh, North Carolina 27699-1700

Checks should be made payable to the Nongame & Endangered Wildlife Fund. For more information about the Fund, see:

<http://www.ncwildlife.org/Give-Donate>

## **7. Contributions of Income Tax Refund or Payment to the North Carolina Education Endowment Fund**

The North Carolina Educational Endowment Fund was created to provide additional support and funding for K-12 public schools. A corporation entitled to a refund of corporate income tax may elect to designate all or part of the refund to the North Carolina Education Endowment Fund. The designation must be made by the corporation on the specified line of the income tax return. The election to contribute to the Fund cannot be changed after the return is filed.

In addition, if the corporation is not due a refund, it may still contribute to this Fund by either making a contribution with the corporate tax return using Form NC-EDU, or by mailing a donation directly to:

North Carolina Department of Public Instruction  
Cash Collections  
6336 Mail Service Center  
Raleigh, NC 27699-6336

Checks should be made payable to the North Carolina Department of Public Instruction and should indicate the contribution is for the North Carolina Education Endowment Fund.

To obtain Form NC-EDU, see:

<https://eservices.dor.nc.gov/vouchers/ncedu.jsp>

## **8. 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.

## **9. Exceptions to the General Statute of Limitations (G.S. § [105-241.6\(b\)\(5\)](#))**

G.S. § [105-241.6\(b\)\(5\)](#) provides an exception to the general statute of limitations for obtaining a refund in the case of a contingent event. A contingent event is litigation or state tax audit that commenced prior to the expiration of the statute of limitations which prevents a taxpayer from filing an accurate or definite request for refund by the expiration of the statute of limitations. Written notice must be provided to the Secretary prior to the expiration of the statute of limitations for refund. Either Form NC-14 or written correspondence can be submitted.

A contingent event may also include an event other than one from a litigation or state tax audit. If a taxpayer contends an “other event” has occurred that prevents the taxpayer from filing an accurate and definite request for refund prior to the expiration of the statute of limitations, a written request to extend the statute of limitations must be provided to the Secretary prior to the expiration of the statute of limitations for refund. If the Secretary agrees to the request, the request for refund must be filed within six months after the event concludes.

For further details and to obtain a Form NC-14, please visit the following websites:

<https://www.ncdot.gov/taxes/information-tax-professionals/exception-general-statute-limitations-certain-events>

<https://www.ncdot.gov/documents/notice-contingent-event-or-request-extend-statute-limitations>

## **S. [Extension of Time for Filing Return](#) (G.S. § [105-263](#))**

### **1. Application for Extension ([17 NCAC 05C.2004](#), G.S. § [105-263](#))**

For tax years beginning on or after January 1, 2025, the extension of time for filing a corporate franchise and income tax return is seven (7) months.

A corporation that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina franchise and income tax return. To receive an automatic State extension, the corporation must certify on the North Carolina tax return that the corporation was granted an automatic federal extension. The automatic extension only applies to extension applications filed by a corporation with

the Commissioner of Internal Revenue. The automatic extension does not apply to extensions granted under section 7508A of the Code because of a presidentially declared disaster.

## **2. Form to be used**

A corporation that is not granted an automatic extension to file a federal income tax return must file Form CD-419 by the original due date of the return to receive an extension for North Carolina franchise and income tax purposes. Form CD-419 is available at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

## **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 for failure to pay the tax when due will be applied to any tax not paid by the original due date, pursuant to G.S. § 105-236.

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.

For filing extensions and payments electronically, see:

<https://www.ncdot.gov/file-pay/eservices>

# **T. 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 does not relieve 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 a taxpayer voluntarily dissolves, the 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 does not relieve 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.”*

## **U. 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. After the Secretary of Revenue certifies these facts to the Secretary of State, the articles of incorporation of the corporation will be suspended. All the powers and privileges of the corporation will cease upon the suspension. However, a suspended corporation’s state tax filing obligations and the payment of its tax liability is not affected by the suspension, nor does a suspension affect the liability of a responsible person under G.S. § 105-242.2. 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 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).

## **V. Exempt Corporations (G.S. §§ 105-130.11, 105-130.12)**

### **1. Preliminary Statement**

Some 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.
- Cooperative banks without capital stock and organized and operated for mutual purposes without profit, telephone membership corporations organized under Chapter 117 of the General Statutes of North Carolina, and electric membership corporations are 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 (to the extent exempt from federal 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 non-forfeitable 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, the membership of which is limited to the owners or occupants of residential units in the condominium, housing development, or cooperative housing corporation. See #5 below for further info on these entities.
- 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 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.
- k. 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.

For information on statutory due dates, *See Subject "Filing of Returns and Payment of Taxes" and "Extension of Time for Filing Return."*

Forms CD-405 and CD-419 are available online at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

**4. Nonprofit Unrelated Business Income for Exempt Organizations under G.S. § 105-130.11(b)**

Most non-profit organizations and cooperative and mutual associations 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.

## **5. Homeowner Association Income under G.S. § [105-130.11\(c\)](#)**

Homeowner associations, condominium associations and cooperative housing corporations are taxed on gross income (excluding membership income), less allowable deductions. “Membership income” is defined as gross income from assessments, fees, charges, or similar amounts received from members used for the preservation, maintenance, and management expenses of the common areas and facilities of residential units. The one thousand dollars (\$1,000) specific deduction does **not** apply to homeowner associations.

## **6. 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.” Organizations can provide a copy of their IRS Form 1120 - REIT to the N.C. Department of Revenue as proof of its qualification.

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.

## **7. 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. Holders of a regular or residual interest in a real estate mortgage investment conduit as defined in Section 860G of the Code are NOT exempt from any tax on the income from that interest.

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

The “North Carolina Limited Liability Company Act” (Chapter 57D) 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. 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.

## **9. 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 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.

## **10. 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.

### **W. Reporting Federal Changes (G.S. §§ [105-130.20](#), [105-241.6](#), [105-241.8](#), [105-241.10](#))**

#### **1. Requirement for Reporting Federal Income Tax Changes**

A federal determination is defined as a change or correction of the amount of a federal tax due arising from an audit by the Commissioner of Internal Revenue. If a taxpayer’s federal taxable income or a federal tax credit is changed or corrected by the Internal Revenue Service or an agreement of the U.S. competent authority, and the change or correction affects the amount of State tax payable, the taxpayer must file an income tax return reflecting each change or correction from a federal determination within six months after being notified of the change or correction.

If a taxpayer fails to report the federal determination within six months and the federal determination increases the amount of State tax payable, the taxpayer must pay a failure to

file penalty of 5% of the additional tax for each month, or part of a month the federal changes are not reported to the Department of Revenue (maximum 25% of the additional tax). If a taxpayer fails to report the federal determination within six months and the change decreases the amount of State tax payable, the taxpayer forfeits the right to any refund due by reason of the federal determination.

Under [G.S. § 105-241.10](#), if the taxpayer files a timely return reflecting a federal determination that affects the amount of State tax payable and the general statute of limitations for proposing an assessment has expired, the Department may assess additional tax that results only from adjustments related to the federal determination if the tax year is otherwise barred by statute. Similarly, a taxpayer is allowed a refund only if the refund is the result of adjustments related to the federal determination if the tax year is otherwise barred by statute.

A taxpayer that voluntarily files an amended federal return and the adjustment increases State tax payable, the taxpayer must file a State amended return within six months of filing the federal amended return. A taxpayer that voluntarily files an amended return and the adjustment decreases State tax payable, the taxpayer may file a State amended return within the general statute of limitations for obtaining a refund.

## **2. Statute of Limitations on Assessments or Refunds**

When a corporation files a timely 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.

If the corporation does not file the return reflecting a federal determination within the required time, an assessment of tax must be proposed within three years from the date the Department received the final report of federal determination.

If the corporation files an amended return as a result of filing a federal amended return and the return is filed within the time required pursuant to North Carolina law, the period for proposing an assessment of any tax due is one year after the return is filed or three years after the original return was filed or due to be filed, whichever is later. If the corporation does not file an amended return within the required time pursuant to North Carolina law, the period for proposing an assessment of any tax due is three years after the due date of the return or three years after the date the federal amended return was filed with the Commissioner of Internal Revenue, whichever is later.

When a timely return reflecting a federal determination results in an overpayment of tax, the period of time for requesting a refund is 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, whichever is later.

### **3. Limits on Refunds and Assessments after a Federal Determination**

When the Department receives a timely return or report reflecting a federal determination that alters the amount of State tax payable and the general statute of limitations has expired, the Secretary may assess for additional tax only if the additional tax is the result of the adjustment reflected in the federal extension. In addition, a taxpayer is only allowed a refund if such refund is the result of an adjustment related to the final determination of federal tax 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 tax year affected by the federal changes.

### **4. Fraud Provisions on Federal Determinations**

When there is a federal determination 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 the failure to file penalty of five percent (5%) per month (twenty-five percent (25%) maximum may be assessed.

## **X. Domestic International Sales Corporation (G.S. §§ [105-130.3](#), [105-130.4](#), and [105-262](#))**

### **1. Doing Business Activities of DISC ([17 NCAC 05C.2401](#))**

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 for apportioning the net income of the DISC shall be computed by including the sales of the parent corporation in the respective sales factors of the DISC. Where the DISC conducts substantial business with a supplier(s) other than its parent, the sales of the supplier(s) may be included in the respective sales factors of the DISC to the extent prescribed by the Secretary of Revenue. The sales of the parent corporation or other supplier(s) included in the sales 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.

## **Y. S Corporations (G.S. § 105-131)**

### **1. Preliminary Statement on Taxed S Corporations**

*Session Law 2021-180 added new section G.S. § 105-131.1A to allow eligible S corporations to elect to pay the North Carolina income taxes at the entity level (a “Taxed S Corporation”). For information regarding Taxed S Corporations, see the section on Taxed Pass-Through Entities in the [Personal Taxes Bulletin](#). **Important:** For purposes of this section, an “S corporation” is NOT a “Taxed S Corporation.”*

### **2. 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.

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

S corporations doing business in North Carolina use Form CD-401S to report activities. Form CD-401S is available at the Department’s website at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

### **4. Return and Payment Due**

The due date of the S Corporation return is the 15<sup>th</sup> day of 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.

## **5. Extension of Filing Date**

An S corporation may obtain an extension of time for filing its franchise and income tax return. For tax years beginning on or after January 1, 2008, and before January 1, 2025, the extension of time is six (6) months from the original due date of the return. For tax years beginning on or after January 1, 2025, the extension of time is seven (7) months from the original due date of the return.

An S corporation that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina franchise and income tax return. To receive an automatic State extension, the S corporation must certify on the North Carolina tax return that the S corporation was granted an automatic federal extension. The automatic extension only applies to extension applications filed by a corporation with the Commissioner of Internal Revenue. The automatic extension does not apply to extensions granted under section 7508A of the Code because of a presidentially declared disaster.

An S corporation that is not granted an automatic extension to file a federal income tax return must file Form CD-419 by the original due date of the return to receive an extension for North Carolina franchise and income tax purposes. Form CD-419 is available at:

<https://www.ncdor.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

## **6. Election**

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 tax period(s) such termination is effective for federal filing purposes.

## **7. Nonresident Shareholder Agreement (Form NC-NA)**

An S corporation with nonresident shareholders is required to submit with the first North Carolina S Corporation 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.

Form NC-NA is available from the Department's website at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

## **8. Franchise Tax, Schedules A and C 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 and C pertain to the corporation franchise tax base and the amount of tax liability.

Effective for tax years beginning on or after January 1, 2019, and applicable to the calculation of franchise tax reported on the 2018 and later tax returns, the franchise tax rate for S Corporations is reduced as follows:

For an S Corporation, as defined in G.S. § 105-130.2, the franchise tax rate is two hundred dollars (\$200) for the first one million dollars (\$1,000,000) of the corporation's tax base and one dollar and fifty cents (\$1.50) per one thousand dollars (\$1,000) of its tax base that exceeds one million dollars (\$1,000,000). The minimum franchise tax for both C Corporations and S Corporations is two hundred dollars (\$200).

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 used by all other corporations.

## **9. Corporate Income of S Corporations Taxed to Shareholders (G.S. § [105-131](#))**

An S corporation is not subject to the tax levied under G.S. § [105-130.3](#). Rather, 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. §§ [105-153.5](#) and [105-153.6](#)).

## **10. 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.

## **Z. 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 income 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. 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 sales in calculating its apportionment factor. 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 net worth 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 sales to determine its net worth franchise tax base.

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

Each QSSS and each parent S corporation doing business in this State must file a separate franchise tax return for each tax 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. INSURANCE PREMIUMS TAX (Article 8B)**

#### **A. General Information (G.S. §§ [105-228.4A](#), [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 taxed under G.S. § [105-228.5](#) are subject to retaliatory provisions.

#### **B. Insurance Companies and Prepaid Health Plans Subject to the Tax (G.S. §§ [105-228.5](#), [58-6-25](#))**

All insurers as defined in G.S. § [58-1-5](#), all hospital service insurers organized as Article 65 corporations under G.S. § 58-65, all hospital maintenance organizations organized under G.S. § 58-67, all prepaid health plans as defined in G.S. § 108D-1, 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, that are doing business in this State 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 service insurers organized as Article 65 corporations, all prepaid health plans, all self-insurers, and all health maintenance organizations are subject to the insurance regulatory charge pursuant to G.S. § [58-6-25](#).

#### **C. Captive Insurance Companies Subject to the Tax (G.S. § [105-228.4A](#))**

All captive insurance companies as defined in G.S. § [58-10-340](#) doing business in this State are subject to gross premium tax pursuant to G.S. § [105-228.4A](#). Every captive insurance company licensed to do business in North Carolina is doing business and is required to file a gross premiums tax return and pay gross premiums tax, unless it meets the requirements of G.S. § 58-10-490. In the case of a branch captive insurance company, only the branch business of the company is subject to gross premium tax. Two or more captive insurance companies under common ownership and control, other than a protected cell captive insurance company or a special purpose captive insurance company with a cell or series structure, are taxed under G.S. § [105-228.4A](#) as a single captive insurance company. Captive insurance companies are not subject to the insurance regulatory charge levied in G.S. § [58-6-25](#) or the retaliatory tax levied under G.S. § [105-228.8](#).

#### **D. Types of Tax and Charges (G.S. §§ [105-228.4A](#), [105-228.5](#), [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 Premium Tax, Additional Tax on Property Coverage Contracts, and Retaliatory Tax are types of insurance premium tax reported. Tax rates, according to the type of insurance written, apply to each type of tax. Premium tax return forms to be used in filing premium tax returns are available on the Department's website at:

<https://www.ncdotr.gov/insurance-gross-premiums-tax-returns-and-instructions>

Other sources of the forms, if used, must obtain prior approval. Supplemental schedules as required by the Department of Revenue must be attached to all returns filed.

Insurers taxed under G.S. § [105-228.5](#), Article 65 corporations, health maintenance organizations, prepaid health plans, and self-insurers are required to pay an Insurance Regulatory Charge in addition to all other fees and taxes. 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 tax year. The insurance regulatory charge does not apply to captive insurance companies taxed under G.S. § [105-228.4A](#).

**E. Tax Basis for Insurers, Article 65 Corporations, Health Maintenance Organizations, Self-Insurers, and Prepaid Health Plans (G.S. § 105-228.5)**

The tax imposed on an insurer taxed under G.S. § [105-228.5](#) is based on gross premiums from business done in the State during the preceding calendar year. Finance charges are included in gross premiums.

The tax imposed on an Article 65 corporation is based on gross collections from membership dues, exclusive of receipts from cost plus plans, received by the corporation during the preceding calendar year.

The tax imposed on a self-insurer is based on gross premiums charged against the same or most similar industry or business, taken from the manual insurance rate then in force in this State, applied to the self-insurer's payroll for the previous calendar year as determined under Article 36 of Chapter 58 of the General Statutes modified by the self-insurer's approved experience modifier.

The tax imposed on a prepaid health plan is based on gross "capitation payments" received by the prepaid health plan from the Department of Health and Human Services for services provided to enrollees in the State Medicaid program or NC Health Choice program in the calendar year. A "capitation payment" is the amount paid by the Department of Health and Human Services to prepaid health plans under capitated contracts for the delivery of Medicaid and NC Health Choice services in accordance with Article 4 of Chapter 108D of the General Statutes. Refunds of capitation payments made by a prepaid health plan to the State are the only allowable deductions. Note: The NC Health Choice program will be eliminated effective on the date the plan of elimination is approved by the Centers for Medicare and Medicaid Services.

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.

In allocating premiums to this State, no distinction is made between the allocation of premium income from a group insurance policy and premium income from individual insurance policies. Gross premiums from group policies providing coverage for individuals living in this State are taxable by this State and should be allocated to North Carolina regardless of the address of the policyholder, policy owner, or beneficiary. The determining factor is residence of the insured. The allocation exception in G.S. § [105-228.5\(b1\)\(1\)](#) does not apply with respect to premium income from insurance policies issued to owners, including trusts, located outside North Carolina but covering North Carolina risks.

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.

For tax years beginning before January 1, 2022, an insurer transacting a bail bond business, is taxed on the full amount of premium paid by a principal or by anyone on behalf of a principal for a bond, and such insurer cannot exclude any paid commission in determining gross premiums from business done in this State.

For tax years beginning on or after January 1, 2022, in regard to an insurer transacting a bail bond business, gross premiums means the amounts received by an insurer from a surety bondsman during the calendar year for bail bonds written on behalf of the insurer. An insurer is subject to the definitions of gross premiums under G.S. § 105-228.5 for gross premiums from transacting any other line of insurance business. The terms "bail bonds," "insurer," and "surety bondsman" have the same meaning as defined in G.S. § 58-71-1.

An insurer taxed under G.S. § [105-228.5](#) 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](#).
- Medicare, Medicaid or NC Health Choice premiums, other than capitation payments, paid by or on behalf of a Medicaid or NC Health Choice beneficiary, to the extent federal law prohibits their taxation. Note: The NC Health Choice program will be eliminated effective on the date the plan of elimination is approved by the Centers for Medicare and Medicaid Services.

#### **F. Tax Basis for Captive Insurers (G.S. § 105.228.4A)**

The tax imposed on captive insurance companies taxed under G.S. § [105-228.4A](#) is based on all direct premiums and assumed reinsurance premiums of a captive insurance company domiciled in the State. In the case of a multiyear policy or contract, the premiums must be prorated among the years covered by the policy or contract. The minimum tax is due even if premium amounts are zero.

Taxable direct premiums do not include amounts paid to policyholders as return premiums. Return premiums include dividends on unabsorbed premiums or premium deposits returned or credited to policyholders. The premium tax on assumed reinsurance premiums does not apply to premiums for risks or portions of risks that are subject to taxation on a direct basis under G.S. § [105-228.4A\(e\)](#). The tax on assumed reinsurance premiums does not apply in connection with the receipt of assets in exchange for the assumption of loss reserves and other liabilities of one insurer by another insurer if the two insurers are under common control and the Commissioner of Insurance verifies 1) the transaction between the insurers is part of a plan to discontinue the operations of one of the insurers and 2) the intent of the insurers is to renew or maintain business with the captive insurance company.

#### **G. Tax Rates and Charges (G.S. §§ 105-228.5, 58-6-25)**

Tax rates and charges for insurers taxed under G.S. § [105-228.5](#) are as follows:

Workers' Compensation	2.50%
Other taxable contracts	1.90%
Prepaid Health Plans	1.90%
Property coverage contracts	(0.74%)**
Article 65 Corporations	1.90%
Health Maintenance Organizations	1.90%
Insurance Regulatory Charge:	
2024 and 2025 calendar years	2.00%*
2026 calendar year	6.50%*

\*Subject to change if the General Assembly determines it is necessary to change the percentage.

\*\*The additional tax on property coverage contracts is imposed on ten percent (10%) of the gross premiums from policies providing coverage for automobile physical damage and one hundred percent (100%) of the gross premium from all other property coverage contracts including policies providing coverage for wind damage (see G.S. § [105-228.5\(d\)\(3\)](#) for definitions).

## **H. Tax Rates and Charges for Captive Insurance Companies (G.S. § [105-228.4A](#))**

Tax rates for captive insurance companies taxed under G.S. § [105-228.4A](#) are as follows:

### Direct Premiums

Up to \$20,000,000	0.400%
\$20,000,000 and more	0.300%

### Assumed Reinsurance Premiums

Up to \$20,000,000	0.225%
\$20,000,000 to \$40,000,000	0.150%
\$40,000,000 to \$60,000,000	0.050%
\$60,000,000 and over	0.025%

The minimum tax is \$5,000 and the maximum is \$100,000 for captives filing as stand-alone captives unless the captive is a protected cell captive insurance company with more than 10 cells. The minimum and maximum tax amounts for a protected cell captive with more than 10 cells or for a special purpose captive with a cell or series structure with more than 10 cells or series are \$10,000 and \$200,000, respectively.

The minimum tax is \$5,000 and the maximum is \$100,000 for a group of captive insurance companies under common ownership and control as determined by the North Carolina Department of Insurance filing as a single captive **unless** the group includes one or more special purpose financial captive insurance companies. If the consolidated group includes one or more special purpose captive insurance companies, the minimum is \$5,000 for the group and the maximum is \$200,000 since the maximum is \$100,000 for the members of the group that are special purpose captives and \$100,000 for the members that are not special purpose financial captives.

The minimum tax is due from each captive that holds an active license to do business even if no premiums have been written.

Note: If a captive insurance company that was formed and licensed under the laws of a jurisdiction other than North Carolina obtains approval from the North Carolina Commissioner of Insurance to redomesticate to North Carolina pursuant to G.S. 58-10-380(g) to operate as a North Carolina-domiciled captive insurance company and redomesticates to this State, is exempt from premium taxes for the year that the redomestication occurs and for the calendar

year following the redomestication. This exemption expires for tax years beginning on or after January 1, 2026.

**I. 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. The additional tax on property coverage contracts is considered a special purpose assessment based on premiums and is not subject to retaliation. Captive insurance companies taxed under G.S. § [105-228.4A](#) are not subject to retaliatory tax.

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.

**J. Installment Payments (G.S. § [105-228.5\(f\)](#))**

Insurers, Article 65 corporations, health maintenance organizations, prepaid health plans, 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 tax year. The due dates are April 15, June 15, and October 15 of each year.

Any insurer, corporation, self-insurer, prepaid health plan, 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. Captive insurance companies are not required to make installment payments of tax due.

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 a taxpayer to pay less than the required installment amount when the insurer or prepaid health plan 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.

**K. 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.

**L. Electronic Funds Transfer (EFT) Requirement (G.S. §§ [105-241](#), [105-236.\(a\)\(1b\)](#))**

Insurance companies paying premium tax of \$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, pursuant to G.S. § 105-236.(a)(1b). Insurers with premium tax liabilities less than \$240,000 may choose to pay the tax electronically using ACH Debit or ACH Credit electronic funds transfer after receiving approval from the Department. For additional information, contact the Insurance Premium Tax Unit. Electronic filing of returns is not available.

**M. Exempt Insurance Companies (G.S. § [105-228.5\(g\)](#))**

The insurance premium tax requirements in G.S. § [105-228.5](#) 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, or to captive insurance companies taxed under G.S. § [105-228.4A](#).

**N. Tax Credits (G.S. §§ [105-228.5A](#), [97-29.1](#), Articles 3D, 3H, 3J, and 3L of Chapter 105)**

**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 Credit for Mill Rehabilitation (Article 3H)**

The tax credit for mill rehabilitation may be taken against gross premium tax. See [G.S. § 105-129.70 – G.S. § 105-129.75A](#) for information on this credit. This credit expires for rehabilitation projects not completed and placed in service before January 1, 2030.

## **4. Tax Credit for Growing Businesses (Article 3J)**

The tax credits for growing businesses may be taken against gross premium tax. See [G.S. § 105-129.80 – G.S. § 105-129.89](#) for information on the credits. The credits are repealed effective for business activities that occur on or after January 1, 2014. However, the Investment in Real Property credit is still available for carryforwards.

## **5. Tax Credit for Investing in Renewable Energy Property**

The tax credit for investing in renewable energy property may be taken against gross premium tax. See [G.S. § 105-129.16A](#) for information on this credit. This credit is repealed effective for renewable energy property placed into service on or after January 1, 2016, but is still eligible to be carried forward.

## **6. Tax Credit for Historic Rehabilitation (Article 3L)**

The tax credit for investing in historic rehabilitation may be taken against gross premium tax. See [G.S. § 105-129.105 – G.S. § 105-129.110](#) for information on this credit. This credit is repealed effective for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2030, and for projects placed in service after January 1, 2032.

## **O. 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 administered by the North Carolina Department of Insurance. Licensing and filing fees of insurers are also administered by the Department of Insurance along with the financial reporting requirements for the insurers.

## **P. 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.

**Q. Exemption From Franchise or Corporate Income Tax (G.S. §§ [105-228.5\(a\)](#), [105-130.11\(a\)\(10\)](#))**

An insurer taxed under G.S. § [105-228.5](#), Article 65 corporation, health maintenance organization, or prepaid health plan that is subject to the insurance gross premium tax in this State is not required to file or pay franchise or corporate income tax. A captive insurance company that is paying insurance premium tax levied under G.S. § [105-228.4A](#) is not required to file or pay franchise or corporate income tax.

**R. Penalties**

All insurers, Article 65 corporations, health maintenance organizations, self-insurers, and prepaid health plans, subject to tax under Article 8B are also subject to the penalties levied in G.S. § 105-236.

## IV. TAX CREDITS (Articles 3C, 3D, 3H, 3K, 3L and 4)

### **A. Overview**

Many of the tax credits available to corporations are repealed or designated for sunset. Please refer to each specific Article for details.

***Effect on Installments and Carryforwards*** – A taxpayer that qualified for a tax credit that has expired, or sunset, may continue to take any remaining installments or carryovers in the current tax year if the taxpayer continues to meet the statutory eligibility requirements previously required of each particular tax credit.

### **B. Tax Credits (Article 4)**

#### **1. General Information**

Please refer to each specific credit for details and utilization rules on taking the credit.

##### **a. Forms**

Form CD-425 is used to report credits that are not limited to fifty percent (50%) of the tax. Form NC-478 is used to calculate and report tax credits that are limited to fifty percent (50%) of the tax, less the sum of all other credits that the taxpayer claims. Form NC-478 is also used to total the specific credits, to determine if the fifty percent (50%) limitation applies, and allocate the limited total credit among the specific credits.

Form CD-425 and, if applicable, form NC-478 must be filed for any tax year in which the taxpayer is eligible to claim a credit, take a credit, or take 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. Form CD-425 and Form NC-478 are available on the Department's website at:

<https://www.ncdot.gov/taxes/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

#### **2. 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 tax 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) tax 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 tax years. The taxpayer must reapply each year for the unused credits.

### **3. Credit for Certain Real Property Donations (NC Conservation Tax Credit)**

#### **a. Credit ([G.S. § 105-130.34A\(a\)](#))**

A C Corporation is allowed a credit against income tax of twenty-five percent (25%) of the fair market value of its qualified donation, subject to the limitations in G.S. 105-130.34A. The amount of the credit cannot exceed five hundred thousand dollars (\$500,000) whether the corporation makes, directly or indirectly as an owner of a pass-through entity, one or more qualified donations during the calendar year. The credit cannot be taken for the year in which the qualified donation is made but may be taken for the taxable year beginning in the calendar year in which the application for the credit becomes effective.

#### **b. Definitions ([G.S. § 105-130.34A\(b\)](#))**

“Allocated credit” is a requested credit minus the reduction required under G.S. 105-130.34A(h).

“Cap remainder” is the amount that is the difference between the maximum amount and the amount of prioritized credit requests allowed.

“Maximum amount” is the amount set out in G.S. 105-130.34A(h) that is the total aggregate amount of all credits allowed to taxpayers under G.S. 105-130.34A and G.S. 105-153.11 for qualified donations made in a calendar year.

“Nonprioritized credit request” is a credit request under G.S. 105-130.34A or G.S. 105-153.11 that is for a qualified donation for a use other than forestland or farmland preservation.

“Prioritized amount” is the amount set out in G.S. 105-130.34A(h) that is for prioritized credit requests.

“Prioritized credit request” is a credit requested under G.S. 105-130.34A or G.S. 105-153.11 that is for a qualified donation for forestland or farmland preservation.

“Qualified donation” is a qualified donation is a donation of a qualified real property interest located in North Carolina that meets all of the following conditions:

- a. It is donated in perpetuity for one of the following uses and is accepted in perpetuity for the use for which the qualified real property interest is donated:
  1. Forestland or farmland preservation.
  2. Fish or wildlife conservation.
  3. A buffer to limit land use activities that would restrict, impede, or interfere with military training, testing, or operations on a military installation or training area or otherwise be incompatible with the mission of the installation.

- 4. Floodplain protection in a county that, in the five years preceding the donation, was the subject of a Type II or Type III gubernatorial disaster declaration, as provided in G.S. 166A-19.21, as a result of a natural disaster.
- 5. Historic landscape conservation.
- 6. Public trails or access to public trails.

b. It is donated to 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 the NC Conservation Tax Credit.

“Qualified real property interest” is as defined in section 170(h)(2) of the Internal Revenue Code.

“Total allocated credits” is total requested credits less any reduction required under G.S. 105-130.34A(h) and G.S. 105-153.11(l).

“Total requested credits” is the sum of nonprioritized credit requests and prioritized credit requests.

**c. Application ([G.S. § 105-130.34A\(c\)](#))**

A C Corporation must file an application with the Secretary to request the NC Conservation Tax Credit. The application must be filed on or before April 15 of the year following the calendar year in which the donation was made. An application is effective for the year in which it is timely filed. The Secretary may not accept late applications. The application must be on a form prescribed by the Secretary and include any information required by the Secretary demonstrating that the donation has met the conditions to qualify for the NC Conservation Tax Credit, including the following items:

- a. A copy of the certification by the Department of Natural and Cultural Resources identifying which of the valid public benefits listed in G.S. 105-130.34A(b)(7) for which the donated qualified real property interest is suitable. The certification for a qualified donation made by a pass-through entity must be filed by the pass-through entity.
- b. A self-contained or summary appraisal report as defined in Standards Rule 2-2 in the latest edition of the Uniform Standards of Professional Appraisal Practice as promulgated by the Appraisal Foundation for the donated qualified real property interest. For fee simple absolute donations of real property, a C Corporation may submit documentation of the county’s appraised value of the donated qualified real property interest, as adjusted by the sales assessment ratio, in lieu of an appraisal report.

**d. Substantiation ([G.S. § 105-130.34A\(d\)](#))**

A C Corporation must maintain and make available for inspection by the Secretary any records the Secretary considers necessary to determine and verify the amount of NC Conservation Tax Credit allowed under G.S. 105-130.34A(a). The burden of proving eligibility for the NC Conservation Tax Credit and the amount of the NC Conservation Tax Credit rests upon the taxpayer, and no NC Conservation Tax Credit may be allowed to a taxpayer that fails to maintain adequate records or to make them available for inspection.

**e. Cap ([G.S. § 105-130.34A\(e\)](#))**

The allocated credit cannot exceed the amount of the 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 C Corporation.

**f. Carryforward ([G.S. § 105-130.34A\(f\)](#))**

If the allocated credit exceeds the cap under G.S. 105-130.34A(e), any unused portion of the allocated credit may be carried forward for the next succeeding five years.

**g. Transferability ([G.S. § 105-130.34A\(g\)](#))**

An allocated credit allowed under G.S. 105-130.34A(a) may not be transferred.

**h. Ceiling, Use, and Allocation ([G.S. § 105-130.34A\(h\)](#))**

The amount of total allocated credits under G.S. 105-130.34A and G.S. 105-153.11 for a taxable year may not exceed five million dollars (\$5,000,000), of which three million two hundred fifty thousand dollars (\$3,250,000) is a prioritized amount. If the total requested credits are equal to or less than the maximum amount, the Secretary shall allow the total requested credits. If the total requested credits are greater than the maximum amount, the Secretary shall allocate the total requested credits in accordance with G.S. 105-130.34A(h).

**h. Reduction ([G.S. § 105-130.34A\(i\)](#))**

If the total requested credits exceed the maximum amount, the Secretary shall prorate the total requested credits in accordance with G.S. 105-130.34A(i). If a requested credit is reduced as provided in G.S. 105-130.34A(i), the Secretary shall notify the C Corporation of the amount of the reduction of the credit on or before December 31 of the year following the calendar year in which the qualified donation was made. The Secretary's allocations based on applications filed under G.S. 105-130.34A(c) are final and shall not be adjusted to account for credits requested but reduced under G.S. 105-130.34A(i). The total requested credits shall be reduced as follows:

- a. If the total requested credits are (i) all prioritized credit requests or (ii) all nonprioritized credit requests, then the Secretary shall prorate the total

requested credits based on the proportion of each requested credit to the total requested credits.

- b. If the total requested credits are (i) a combination of prioritized credit requests and nonprioritized credit requests and (ii) the amount of prioritized credit requests is equal to or less than the prioritized amount, the Secretary shall first allow the prioritized credit requests. The Secretary shall then prorate the cap remainder based on the proportion of each of the remaining requested credits to the total requested credits less the prioritized amount.
- c. If the total amount of requested credits is (i) a combination of prioritized credit requests and nonprioritized credit requests and (ii) the amount of prioritized credit requests is greater than the prioritized amount, the Secretary shall first prorate the prioritized credit requests based on the proportion of each prioritized credit request to the prioritized amount. The Secretary shall then prorate the cap remainder, including the remainder of any prioritized credit requests, based on the proportion of each of the remaining requested credits to the total requested credits less the prioritized amount.

For more information on the NC Conservation Tax Credit, see the [Department's Directive TA-25-1](#).

## **C. Tax Incentives for Recycling Facilities (Article 3C)**

### **1. General Information**

#### **a. Qualifications**

A recycling facility qualifies for the tax credits provided in this Article and Article 5 for major recycling facilities if:

- 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.

#### **b. Forfeiture ([G.S. § 105-129.26\(c\)](#))**

If the owner of 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 no longer qualifies for the recycling tax benefits provided in Article 3C and Article 5 and forfeits all tax credits previously received under this Article and in Article 5. 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](#).

**c. Substantiation ([G.S. § 105-129.26\(d\)](#))**

The burden of proving eligibility for the 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. Forms**

Form CD-425 is used to report the tax credit claimed under this Article. This form must be filed for any tax year in which a credit or a carryforward of a credit against the taxpayer's tax liability for that year is claimed.

**2. Credit for Investing in 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 tax year is allowed a credit equal to fifty percent (50%) of the amount payable by the owner during the tax 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 tax 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](#) or [G.S. § 105-129.88](#).

**D. Historic Rehabilitation Tax Credits (Article 3D)**

This Article expired for qualified expenditures incurred on or after January 1, 2015, and was replaced with a new historic rehabilitation credit in Article 3L discussed in subsection G. For qualified expenditures incurred before January 1, 2015, the tax credit expires for property not placed in service by January 1, 2023. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing Form CD-425.

Article 3L replaced Article 3D credits and is effective for qualified expenditures incurred on or after January 1, 2016.

**E. Credit for Mill Rehabilitation (Article 3H)**

**1. General Projects ([G.S. § 105-129.71](#))**

**a. General Information ([G.S. § 105-129.73\(a\)](#), [G.S. § 105-129.75](#))**

This Article was reenacted and now expires for rehabilitation projects not completed and placed in service prior to January 1, 2030. If the eligible site is placed in service in two or more phases in different years, the amount of tax credit that may be claimed in a year is the amount based on the qualified rehabilitation expenditures associated with the phase placed into service during that same year.

This Article previously had expired January 1, 2015, for rehabilitation projects for which an application is submitted on or after such date. The reenactment and extension of Article 3H tax credits does not require a taxpayer that obtained an eligibility certificate prior to

January 1, 2015, for a rehabilitation project under this Article to reapply for an eligibility certification for the same project.

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.

Eligible taxpayers may take installments and carryforwards of prior year credits by completing Form CD-425.

**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.

**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.

**b. Credit for Income-Producing Rehabilitated Mill Property (G.S. § 105-129.71)**

**Credit:**

A taxpayer that is allowed a federal income tax credit under Code section 47 for making qualified rehabilitation expenditures of at least three million dollars (\$3,000,000) with respect to a certified rehabilitation of 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 138 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 the eligibility certification.
- Thirty percent (30%) of the qualified expenditures if the eligible site is located in a tier four or five area on the date of the eligibility certification.

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.

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).

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.

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.

**c. Credit for Nonincome-Producing Rehabilitated Mill Property (G.S. § 105-129.72)**

Credit:

A taxpayer that is not allowed a federal income tax credit under Code section 47 and that makes qualified rehabilitation expenses of at least three million dollars (\$3,000,000) with respect to a certified rehabilitation of 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 the eligibility certification. No credit is allowed if the eligible site is in a tier four or five area.

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 140 owners for each year in which the allocated credit is claimed.

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.

**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.

**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.

**2. Railroads (Effective November 1, 2019, [G.S. § 105-129.71\(a1\)](#))**

The Mill Rehabilitation Tax Credit was reenacted for an eligible railroad station that is allowed a credit under section 47 of the Code. Taxpayers incurring qualified rehabilitation expenses of at least ten million dollars (\$10,000,000) for a certified rehabilitation of an eligible railroad station are eligible for a tax credit under this Article. To qualify, a copy of the eligibility certification and cost certification must be provided to the Secretary.

An eligible railroad station is a site located in this State and that meets all of the following conditions:

- a. Used as a manufacturing facility and as a railroad station or is located adjacent to a site that is or was used as a railroad station.
- b. Is a certified historic structure or State-certified historic structure.
- c. Has been at least eighty percent (80%) vacant for at least two years immediately preceding the eligibility certification date.
- d. Is a designated local landmark certified by a city on or before June 30, 2027.
- e. Is located in a tier one or two development area, determined as of the eligibility certification date.
- f. Is located in a designated qualified opportunity zone under sections 1400Z-1 and 1400Z-2 of the Code, determined as of the eligibility certification date.
- g. Is issued a certificate of occupancy on or before December 31, 2029.

Taxpayers with income-producing mill rehabilitation projects that meet the above conditions are allowed a credit equal to forty percent (40%) of the rehabilitation expenses that qualify for the federal credit and are incurred on or after January 1, 2019, and before January 1, 2030.

The credit expires for rehabilitation projects not placed in service prior to January 1, 2030. The credit cannot be claimed for a tax year prior to January 1, 2021.

Note: Taxpayers cannot claim a tax credit under Article 3H if they have already claimed a tax credit under Article 3D or Article 3L for the same activity. The rules and fee schedule used in Article 3L is also used for Article 3H tax credits.

## **F. Historic Rehabilitation Tax Credits (Article 3L)**

### **1. General Information (This Article replaced Article 3D credits and is effective for qualified expenditures incurred on or after January 1, 2016)**

#### **a. Tax Credited (G.S. § [105-129.108\(a\)](#))**

The credits provided in this Article are allowed against franchise tax, income tax, or gross premiums tax. The taxpayer must elect the tax against which the credit will be claimed when filing the return on which it is claimed. Any future carryforwards of unused credits must be claimed against the same tax.

#### **b. General Credit Limitations (G.S. § [105-129.108\(c\)](#))**

A credit allowed may not exceed the amount of tax against which it is claimed for the tax year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer. A taxpayer claiming a credit under Article 3L may not also claim a credit under Article 3D or 3H with respect to the same activity.

Any unused portion of a credit may be carried forward for the succeeding nine (9) years.

#### **c. Forms (G.S. § [105-129.108\(b\)](#))**

A taxpayer must claim the historic rehabilitation tax credit on the tax return filed for the tax year in which the certified historic structure is placed in service. In the year the taxpayer qualifies for the tax credit, Form NC-Rehab must be filed. This requirement applies even if the taxpayer's tax liability for that year is not large enough for the taxpayer to take the credit. For more information see the Instructions for Form NC-Rehab.

In addition, Form CD-425 is used to report any tax credits claimed under this Article. This form along with Form NC-Rehab must be filed for any tax year in which a credit or carryover of a credit against the taxpayer's tax liability for that year is claimed. When and income-producing property is placed into service in two or more phases in different years, the amount of credit is based on the expenditure amount associated with the phase placed into service during the respective year.

**d. Rules and Fees (G.S. § [105-129.107](#))**

The North Carolina Historical Commission, in consultation with the State Historic Preservation Officer, may adopt rules to administer Article 3L and a schedule of fees, not to exceed 1% of the completed qualifying rehabilitation expenditures.

**e. Sunset (G.S. § [105-129.110](#))**

Article 3L expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2030. For qualified rehabilitation expenditures and rehabilitation expenses incurred prior to January 1, 2030, this Article expires for property not placed in service by January 1, 2032.

**2. Credit for Rehabilitating Income-Producing Historic Structure (G.S. § [105-129.105](#))**

**a. Credit (G.S. § [105-129.105\(a\)](#))**

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 the sum of the following:

- i. Base amount – 15% of qualified rehabilitation expenses up to 10 million dollars, plus 10% of qualified rehabilitation expenses in excess of 10 million dollars up to 20 million dollars.
- ii. Development tier bonus – An amount equal to 5% of qualified rehabilitation expenses not exceeding 20 million dollars if the certified historic structure is located in a tier one or tier two area, as defined in G.S. § 143B-437.08.
- iii. Targeted investment bonus – An amount equal to 5% of qualified rehabilitation expenses not exceeding 20 million dollars if the certified historic structure is located in North Carolina and meets all the following criteria:
  - (A) It was used as a manufacturing facility or for purposes ancillary to manufacturing, a warehouse for selling agricultural products, or as a public or private utility;
  - (B) It is a certified historic structure; and
  - (C) It has been at least 65% vacant for a period of at least two years immediately preceding the date the eligibility certification was made.
- iv. Education bonus – An amount equal to 5% of qualified rehabilitation expenditures not exceeding 20 million dollars if the certified historic structure was originally used for an educational purpose, is used for an educational purpose following the rehabilitation, and remains used for an educational purpose for each year that the credit, or carryforward of the credit, is claimed. If the certified historic structure is used for multiple purposes, the bonus provided will be proportionate to the area of the historic structure used for an educational purpose. The term “educational purpose” is a purpose that has as its objective the education

or instruction of human beings; it comprehends the transmission of information and the training or development of the knowledge or skills of individual persons.

For purposes of the credit, the terms “qualified rehabilitation expenditures” and “certified historic structure” have the same meaning as under section 47 of the Code, and an “eligibility certification” is certification obtained from the State Historic Preservation Officer, defined in G.S. § [105-129.105\(c\)\(7\)](#).

**b. Credit Limitation (G.S. § [105-129.105\(d\)](#))**

The total amount of credit allowed for qualified rehabilitation expenditures for an income-producing certified historic structure may not exceed 4.5 million dollars.

**c. Allocation from Pass-Through Entity (G.S. § [105-129.105\(b\)](#))**

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 tax 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 tax year in which an allocated credit is claimed. A pass-through entity is defined in [G.S. § 105-228.90](#).

**d. Forfeiture for Disposition (G.S. § [105-129.108\(d\)](#))**

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.

**e. Forfeiture for Change in Ownership (G.S. § [105-129.108\(e\)](#))**

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.

**f. Exceptions to Forfeiture (G.S. § [105-129.108\(f\)](#))**

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.

**g. Liability from Forfeiture (G.S. § [105-129.108\(g\)](#))**

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 were not allowed. The past taxes plus interest are due 30 days from 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 the penalties provided in G.S. § [105-236](#).

**h. Substantiation (G.S. § [105-129.108\(h\)](#))**

A taxpayer claiming this credit must provide any information required by the Secretary, including filing with the tax return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has met the rehabilitation requirements of Article 3L, and a copy of the eligibility certification if the historic structure is located in an eligible targeted investment site and the targeted investment bonus is claimed. A taxpayer must also maintain and make available for inspection by the Secretary all records necessary to determine and verify the amount of credit claimed.

**3. Credit for Rehabilitating Non-Income-Producing Historic Structure  
(G.S. § [105-129.106](#))**

**a. Credit (G.S. § [105-129.106\(a\)](#))**

A taxpayer that is not allowed a federal income tax credit under section 47 of the Code and who incurs rehabilitation expenses of at least 10 thousand dollars for a non-income producing State-certified historic structure is allowed a credit equal to 15% of the rehabilitation expenses.

“Rehabilitation expenses” are expenses incurred in the certified rehabilitation of a certified historic structure and added to the property’s basis. The expenses must be incurred within a 24-month period on a discrete property parcel. The term does not include the costs of acquiring the property, site work, personal property, or amounts attributable to enlargement of an existing building.

A “State-certified historic structure” is one that is individually listed in the National Register of Historic Places or is certified by the State Historic Preservation Officer, as defined in G.S. § [105-129.105\(c\)\(7\)](#), as contributing to the historic significance of a National Register Historic District or locally designated historic district certified by the U.S. Department of the Interior.

**b. Limitations (G.S. § [105-129.106\(b\)](#))**

The amount of credit allowed for rehabilitation expenses for a non-income producing historic structure may not exceed \$22,500 per discrete property parcel, as defined in G.S. § [105-129.106\(c\)\(2\)](#). A taxpayer that is the transferee of a State-certified historic structure with rehabilitation expenses is only allowed a credit if the transfer occurs before the structure is placed in service. In such a case, the transferee is the only taxpayer that may claim the credit and the transferor must provide the transferee with documentation detailing the amount of rehabilitation expenses and credit. The date a property is placed in service is the later of the date on which the rehabilitation is completed or the date in which the property is used for its intended purpose.

A taxpayer can only claim a credit once during any five-year period, not including carryovers.

**c. Substantiation (G.S. § [105-129.108\(h\)](#))**

A taxpayer claiming this credit must provide any information required by the Secretary, including filing with the tax return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has met the rehabilitation requirements of Article 3L. A taxpayer must maintain and make available for inspection by the Secretary all records necessary to determine and verify the amount of credit claimed.

**G. [Tax Incentive for Railroad Intermodal Facility](#) (Article 3K) (This Article is repealed for tax years beginning on or after January 1, 2038)**

**1. Credit ([G.S. § 105-129.96](#))**

A taxpayer that constructs or leases an eligible railroad intermodal facility in this State 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 if the facility is placed in service in this State during the tax year. No credit is allowed under this section to the extent the cost of the eligible railroad intermodal facility was provided by public funds. 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.

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.

**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 Article is repealed effective for tax years beginning on or after January 1, 2038.

**Appendix A. DISASTER RELIEF**  
**(North Carolina Emergency Management Act – Chapter 166A, Article 1A, Part 8)**

**1. General Information (G.S. § 166A-19.70A)**

Effective August 1, 2019, nonresident businesses and nonresident employees who temporarily come to North Carolina at the request of a critical infrastructure company solely to perform disaster-related work during a disaster response period are excluded from certain tax and regulatory requirements.

A nonresident business or nonresident employee is exempt from the following tax and regulatory requirements:

- Corporate income tax, as provided under G.S. § [105-130.1](#)
- Individual income tax, as provided under G.S. § [105-153.2](#)
- Franchise tax, as provided under G.S. § [105-114](#)
- Unemployment tax, as provided under G.S. § 96-1(b)(12)
- Certificate of Authority from the Secretary of State to transact business in this State, as provided under G.S. § 55-15-01(d) and G.S. § 57D-1-24(d)

**2. Franchise Tax (G.S. § [105-114\(d\)](#))**

A nonresident business that solely performs disaster-related work in this State during a disaster response period at the request of a critical infrastructure company is not considered to be doing business in this State for franchise tax purposes, subject to the definitions and provisions in G.S. § 166A-19.70A. Therefore, the nonresident business is not subject to the State's franchise tax and is not required to file a franchise tax return.

See sections 4, 5, and 6 below for more information on the limitations, notifications, and definitions of the disaster relief provisions under G.S. § 166A-19.70A.

**3. Corporate Income Tax (G.S. § [105-130.1](#))**

A nonresident business that solely performs disaster-related work in this State during a disaster response period at the request of a critical infrastructure company is not considered to be doing business in this State for corporate income tax purposes, subject to the definitions and provisions in G.S. § 166A-19.70A. Therefore, the corporation is not subject to the State's corporate income tax and is not required to file a corporate income tax return.

See sections 4, 5, and 6 below for more information on the limitations, notifications, and definitions of the disaster relief provisions under G.S. § 166A-19.70A.

**a. Additional Requirement for C Corporations**

C corporations are required to make the following addition to federal taxable income in determining State net income:

- Payments made to an affiliate or subsidiary that is not subject to corporate income tax pursuant to exceptions for critical infrastructure disaster relief provided under G.S. § 166A-19.70A, to the extent the payments are deducted in determining federal taxable income.

### **b. Additional Requirement for S Corporations**

An S corporation is not required to file a tax return with the Department if it is not doing business in this State because it is a nonresident business performing disaster-related work during a disaster response period at the request of a critical infrastructure company.

However, the S corporation must furnish to each shareholder who would be entitled to share in the corporation income any information necessary for that person to properly file a State income tax return (G.S. § [105-131.7\(f\)](#)).

## **4. Limitations (G.S. § 166A-19.70A(e))**

The tax and regulatory relief provided in the disaster relief provisions is subject to all of the following limitations:

- i. Applies only to nonresident businesses and nonresident employees who come into the State at the request of a critical infrastructure company.
- ii. Applies only to disaster-related work performed during a disaster response period.
- iii. Applies only if the nonresident business or nonresident employee has no other income attributable to this State.

The relief provided does not apply to any tax year that is part of the disaster response period if the nonresident business or nonresident employee continues to perform disaster-related work following the end of the disaster response period.

In addition, it does not apply to a tax year that is part of the disaster response period if the nonresident business or nonresident employee is required to file an income tax return for that tax year with the Department of Revenue for reasons other than the performance of disaster-related work.

## **5. Required Notifications**

### **a. Critical Infrastructure Company Notification (G.S. § 166A-19.70A(c))**

A critical infrastructure company is required to provide notification to the Department of Revenue within 90 days of the expiration of the disaster response period. The notification must be in the form and manner required by the Department and must include the following:

- i. A list of all nonresident businesses who performed disaster-related work in this State during a disaster response period at the request of the critical infrastructure company.

- ii. A list of nonresident employees who performed disaster-related work in this State for the critical infrastructure company during a disaster response period. The notification must include the amount of compensation paid to the nonresident employee performing disaster-related work in this State.

A link to Form NC-CICN (Critical Infrastructure Company Notification) and its instructions can be found on the Corporate Tax Forms and Instructions webpage below:

<https://www.ncdor.gov/taxes-forms/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

**c. Nonresident Business Notification (G.S. § 166A-19.70A(d))**

A nonresident business is required to provide notification to the Department of Revenue within 90 days of the date the nonresident business concludes its disaster-related work in the State. The notification must be in the form and manner required by the Department and must include the following:

- i. A list of nonresident employees who perform disaster-related work in this State during a disaster response period.
- ii. The amount of compensation paid to the nonresident employee performing disaster-related work in this State.

A link to Form NC-NBN (Nonresident Business Notification) and its instructions can be found on the Corporate Tax Forms and Instructions webpage below:

<https://www.ncdor.gov/taxes-forms/corporate-income-franchise-tax/corporate-tax-forms-and-instructions>

**Note: Failure to timely submit the nonresident business notification forfeits the tax relief provided for the nonresident business.**

**6. Definitions (G.S. § 166A-19.70A(b))**

The definitions applicable to the disaster relief provisions include the following:

- Corporation – Defined in G.S. § [105-130.2](#).
- Critical infrastructure – Property and equipment owned or used by a critical infrastructure company for utility or communications transmission services provided to the public in the State. Examples include communications networks; electric generation, transmission and distribution systems; natural gas transmission and distribution systems; water pipelines; and related support facilities. Related support facilities may include buildings, offices, lines, poles, pipes, structures, and equipment.

- Critical infrastructure company – Either a registered public communications provider or a registered public utility.
- Disaster-related work – Repairing, renovating, installing, building, or performing services on critical infrastructure that has been damaged, impaired, or destroyed as a result of a disaster or emergency in an area covered by the disaster declaration.
- Disaster response period – Begins 10 days prior to the first day of a disaster declaration and expires on the earlier of the following:
  - 60 days following the expiration of the disaster declaration, as provided under G.S. § 166A-19.21(c).
  - 180 days following the issuance of the disaster declaration.
- Employee – Defined in G.S. § [105-163.1](#).
- Nonresident business – An entity that has not been required to file an income or franchise tax return with the State for three years prior to the disaster response period, other than those arising from the performance of disaster-related work during a tax year prior to the enactment of this section, and that meets one or more of the following conditions:
  - Is a nonresident entity.
  - Is a nonresident individual who owns an unincorporated business as a sole proprietor.
- Nonresident employee – A nonresident individual who is one of the following:
  - An employee of a nonresident business.
  - An employee of a critical infrastructure company who is temporarily in this State to perform disaster-related work during a disaster response period.
- Nonresident entity – Defined in G.S. § [105-163.1](#).
- Nonresident individual – Defined in G.S. § [105-153.3](#).
- Registered public communications provider – A corporation doing business in this State prior to the disaster declaration that provides the transmission to the public of one or more of the following:
  - broadband
  - mobile telecommunications
  - telecommunications
  - wireless internet access
- Registered public utility – A corporation doing business in this State prior to the disaster declaration that is subject to the control of one or more of the following entities:
  - North Carolina Utilities Commission
  - North Carolina Rural Electrification Authority
  - Federal Communications Commission
  - Federal Energy Regulatory Commission