2025 PERSONAL TAXES BULLETIN

Individual Income Tax
Pass-Through Entities
Withholding Tax

Personal Taxes Division

February 2026

PREFACE

The Personal Taxes Bulletin was prepared for the purpose of presenting the administrative interpretation and application of North Carolina income tax laws relating to individuals, partnerships, S corporations, estates, trusts, and income tax withholding in effect at the time of publication. This publication supplements the information 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administrative rule, or case law subsequent to the date of this publication, the provisions in this bulletin may be superseded or voided.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.

In general, the Personal Taxes Bulletin addresses the tax law applicable to filing an individual income tax return or an income tax return for a pass-through entity for tax year 2025 and income tax withholding responsibilities during tax year 2026.

Revised February 2026

Issued by:

Personal Taxes Division
Tax Administration
North Carolina Department of Revenue
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List of Common Abbreviations

The following is a list of commonly used abbreviations in this document:

AGI – Adjusted Gross Income

Code and **IRC** – Internal Revenue Code. Unless otherwise noted, this refers to the Internal Revenue Code as enacted as of January 1, 2023, including any provisions enacted as of that date that become effective either before or after that date.

Department – North Carolina Department of Revenue

G.S. – North Carolina General Statutes

IRS – Internal Revenue Service

PTE – Pass-Through Entity

Secretary – Secretary of the North Carolina Department of Revenue

Taxed Partnership – A partnership that makes the election to have North Carolina income tax paid at the entity level

Taxed PTE – Taxed Pass-Through Entity

Taxed S Corporation – An S Corporation that makes the election to have North Carolina income tax paid at the entity level

I. Filing Individual Income Tax Returns

1. Forms

A taxpayer must use the North Carolina income tax return forms and schedules for the year that the taxpayer's tax year begins. The individual income tax return, Form D-400, and other supporting forms and schedules can be obtained from the Department's website. Form D-400 can also be obtained from the main office in Raleigh or from any of the Department's Service Centers located throughout the State. For locations and hours of operation, see Office Locations on the Department's website.

Reference: 17 NCAC 06B .0104; 17 NCAC 01C .0322.

2. Electronic Tax Filing (eFile)

A taxpayer may file a tax return with the Department of Revenue electronically only when the Department has established and implemented procedures permitting electronic filing of a specific tax return. A return may be filed electronically only by using the procedures established by the Department for the particular return.

Electronic tax filing (eFile) is an electronic method of filing and paying income taxes using third party tax preparation software approved by NCDOR. Visit eFile for Taxpayers for information about the Department's authorized eFile programs.

When filing electronically, tax practitioners and taxpayers must eFile using IRS and Department approved, commercially developed, software products. Visit Approved eFile Software Products to access a list of approved software products. To participate in the Federal/State eFile program, a tax practitioner should refer to Federal Publication 3112, Applying and Participating in IRS E-file.

Reference: 17 NCAC 01C .0701.

3. Items Requiring Special Attention

The individual taxpayer or the taxpayer's agent should give careful attention to the answering of all questions and to the completion of all applicable schedules on the return. Incomplete or inaccurate information, or the failure to sign a return, may result in the returning of the forms to the taxpayer, thereby delaying the processing of the return and any refund due thereon. Specifically, the individual taxpayer or the taxpayer's agent should give special attention to the following items:

a. When filing an income tax return, the forms and schedules for that tax year must be used. For example, a taxpayer whose calendar year ends December 31, 2025, must use 2025 forms and schedules. A taxpayer filing on a fiscal year basis whose fiscal year begins in 2025 must also use the 2025 forms and schedules.

b. The first name, middle initial, last name and the current mailing address of the taxpayer(s) should be printed in the appropriate boxes on the tax return. Do not use the name or address shown on a wage and tax statement if incorrect. Enter the entire nine-digit social security number of each taxpayer in the appropriate boxes.

c. If you are a personal representative and you are filing an income tax return for an unmarried individual or a married filing separately return for a married individual who died during the taxable year, enter the name of the decedent and your address in the "Name and Address" section of Form D-400. In the "Deceased Taxpayer Information" section, fill in the circle and enter the taxpayer's date of death in the appropriate box.

d. If you are a surviving spouse and you choose to file a married filing joint tax return with your spouse who died during the taxable year, enter your name, the name of the decedent, and your address in the "Name and Address" section of Form D-400. In the "Deceased Taxpayer Information" section, fill in the circle and enter the date of the decedent's death in the appropriate box.

e. If you are a surviving spouse and you choose to file a married filing separately tax return for your spouse who died during the taxable year, enter the name of the decedent and your address in the "Name and Address" section of Form D-400. In the "Deceased Taxpayer Information" section, enter the date of the decedent's death in the appropriate box.

f. The taxpayer is required to furnish a social security number with the return. This number is necessary to verify the identity of the taxpayer because the Department identifies taxpayers and credits refunds and payments by social security number. Separate returns of spouses are often interrelated whether they are living together or apart; therefore, the taxpayer is asked to furnish the name and social security number of the spouse if they file on separate forms, but not if they are divorced. This information can save time, correspondence, and difficulty for the taxpayer and the Department.

g. The filing status claimed on the federal return must also be claimed on the North Carolina income tax return. Generally, if the taxpayer has not filed a federal income tax return, the taxpayer must claim the filing status to which the taxpayer is entitled under the Internal Revenue Code. However, for a married couple filing a joint federal income tax return, if either the taxpayer or the taxpayer's spouse is a nonresident and has no North Carolina taxable income for the taxable year, the filing status married filing separately may be claimed on the North Carolina income tax return. Importantly, once a joint return is filed, separate returns may not be filed for that year after the due date of the return.

h. The tax must be computed accurately by multiplying North Carolina taxable income by the tax rate in G.S. § 105-153.7. In the case of a delinquent return, the penalties prescribed by G.S. § 105-236(a)(3) and G.S. § 105-236(a)(4) and interest prescribed by G.S. § 105-241.21 must be added.

i. If additional tax is due on the income tax return, it can be paid by check or money order with the return, or it can be paid online by bank draft (free) or credit or debit card using Visa or MasterCard ($2 convenience fee for every $100 paid). To pay online, see eFile for Individuals.

Note: The Department will not accept a check, money order, or cashier's check unless it is drawn on a U.S. (domestic) bank and the funds are payable in U.S. dollars.

j. If an individual has moved into or out of North Carolina during the tax year or is a nonresident with income from sources within North Carolina, the portion of the taxpayer's federal gross income, as adjusted, that is subject to North Carolina income tax must be determined by completing Form D-400 Schedule PN, Part Year Resident and Nonresident Schedule.

Note: Taxpayers required to complete Form D-400 Schedule PN must review Form D-400 Schedule PN-1 to determine if they need to report North Carolina adjustments that relate to gross income that were not specifically listed on Form D-400 Schedule PN. North Carolina adjustments that relate to gross income for tax year 2025 that do not have a designated line on Form D-400 Schedule PN for tax year 2025 are listed on Form D-400 Schedule PN-1 for tax year 2025.

k. Credit for tax paid to another state is not allowed to an individual moving into or out of this state unless the individual has income derived from and taxed by another state or country while a resident of this State. For more information, see Credit for Income Tax Paid to another State or Country.

l. If a tax credit is claimed for tax paid to another state or country, a copy of the return filed with the other state or country and a canceled check, receipt, or other proof of payment of tax to the other state must be attached to the North Carolina return.

m. Every return must be signed and dated by the taxpayer or the taxpayer's authorized agent, and joint returns should be signed and dated by both spouses. A refund may be delayed by an unsigned return. The affirmation statement for the D-400 states that upon signing the return, the taxpayer is declaring and certifying that the taxpayer has examined the return and all accompanying schedules and statements, and that they are true, correct, and complete.

n. Where tax has been withheld, the original or copy of the original State wage and tax statement that was received from an employer must be attached to the return. Wage and tax statements or 1099 statements generated by tax software programs cannot be used to verify North Carolina tax withheld. The Department may request the original State wage and tax statements to verify tax has been withheld from taxpayers that file electronically.

o. Any additional information that will assist in the processing and examination of a return should be attached to the return. If Form NC-478 or Form NC-Rehab are being filed, the form(s) must be attached to the front of Form D-400.

p. Anyone who is paid to prepare a return must sign and date the return in the space provided. When more than one person prepares a return, the preparer with primary responsibility for the overall accuracy of the return must sign as the preparer. The preparer must manually sign and date the prepared return. Preparers may use the practitioner ID number (PTIN) in lieu of their social security number. Preparers should also include their phone numbers in the space provided.

   Note: A taxpayer and the taxpayer's spouse, if filing a joint return, can authorize the Department to discuss the return and attachments with the paid preparer of the return by checking the applicable box in the signature area of the return. Importantly, the authorization applies only to the individual whose signature appears in the "Paid Preparer Use Only" section of the return. The authorization does not apply to the firm, if any, shown in the paid preparer section.

q. Nonresident aliens are required to file income tax returns at the same time they are required to file their federal returns.

r. Individuals performing disaster-related work in North Carolina during a disaster response period at the request of a critical infrastructure company should review the information provided in Critical Infrastructure Disaster Relief Work.

   Reference: 17 NCAC 06B .0102; 17 NCAC 06B .0104; 17 NCAC 01C .0322.

4. Substitute Returns

The Department prohibits the use of forms in software tax products without prior approval. Substitute forms are computer generated tax forms created by third parties, which must be approved by the Department. Information related to the development and production of substitute forms can be obtained from the Department's website. For questions concerning the reproduction of North Carolina tax forms, email allaboutforms@ncdor.gov.

Returns that cannot be processed by the Department's imaging and scanning equipment may be returned to the taxpayer with instructions to refile on an acceptable form.

Reference: 17 NCAC 01C .0601.

5. Federal Forms

Taxpayers must include a copy of their federal return with the North Carolina return unless their federal return reflects a North Carolina address.

Reference: 17 NCAC 06B .0106.

6. Extensions

a. General

If you cannot file your North Carolina Individual Income Tax Return, Form D-400, by the due date of the return, you may apply for a six-month extension of time to file the return. The due date of the individual income tax return for a calendar year taxpayer is April 15th. For a taxpayer with a fiscal year end, the due date of the individual income tax return is the fifteenth day of the fourth month following the close of the fiscal year.

A taxpayer who is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina income tax return. In order to receive an automatic State extension, the taxpayer must certify on the North Carolina tax return that the person was granted an automatic federal extension. The automatic extension only applies to extension applications filed by a taxpayer 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 taxpayer who is not granted an automatic extension to file a federal income tax return must file Form D-410, Application for Extension for Filing Individual Income Tax Return, by the due date of the return in order to receive an extension for North Carolina income tax purposes. Without a valid extension, an individual income tax return filed after the due date is delinquent and subject to interest and all applicable penalties provided by law. For information on applicable penalties and interest, see Penalties and Interest.

You are not required to send a payment of the tax you expect to owe to receive an extension; however, it will benefit you to pay as much as you can by the due date. An extension of time may be granted even if the application for extension is not accompanied by a payment of the tax due. However, an extension of time for filing a tax return does not extend the time for paying the tax due. If you do not pay the amount of tax due by the due date of the return, you will owe a late payment penalty and interest. The late payment penalty will not be due if you pay at least 90 percent (90%) of your tax liability through withholding, estimated tax payments, or with Form D-410 by the due date of the return.

If married individuals make a joint extension tax payment and then file separate income tax returns, the married individuals must determine how to divide the extension tax payment between the individuals.

If your return is complete by the due date but you are not able to pay the tax you owe, you should not request an extension. Instead, file your return by the due date and pay as much tax as you can to minimize any penalties and interest due. You must also request an extension if you expect a refund but cannot file your return by the due date. You will not receive your refund until you file your income tax return.

Reference: 17 NCAC 06B .0107; G.S. § 105-263.

b. Out of Country Extension

If you are required to file a North Carolina individual income tax return and you are out of the country on the due date of the return, you are granted an automatic four-month extension for filing your North Carolina individual income tax return if you fill in the "Out of Country" circle on Page 1 of Form D-400. "Out of Country" means you live outside the United States and Puerto Rico and your main place of work is outside the United States and Puerto Rico, or you are in military service outside the United States and Puerto Rico. The time for payment of the tax is also extended; however, interest is due on any unpaid tax from the due date until the tax is paid.

If you are unable to file your income tax return within the automatic four-month extension period, an additional two-month extension may be obtained by filling in the circle at the bottom right of Form D-410 or selecting "Y" at the "Out of country on due date prompt" on the Department's personalized form creator. To receive the additional two-month extension, Form D-410 must be filed by August 15. Importantly, a taxpayer who is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding State income tax return if they certify on the State return that the federal extension was granted. Consequently, an "Out of Country" taxpayer granted an automatic six-month extension to file the State income tax return will not be required to file Form D-410 to receive the additional two-month extension.

Reference: 17 NCAC 06B .0107; G.S. § 105-263.

c. Request an Extension

You can request an extension and pay tax online using the following options:

- eFile – File Form D-410 and remit your tax payment using a tax professional or commercial tax preparation software (see Approved eFile Software Products). Using eFile allows you to file federal and State forms at the same time or separately. Free eFile is available for those who qualify.

- Online File and Pay– File Form D-410 and remit your tax payment using the Department's website.

If you are unable to apply for an extension and pay your tax online or if you want to file your extension in paper form, you can create a personalized Form D-410.

For more information on applying for an extension, see Extensions and Frequently Asked Questions about Filing an Application for Extension to File Your N.C. Individual Income Tax Return.

7. Amended Returns

If you need to amend the **2025** individual income tax return, complete and file (1) Form D-400 (fill in the applicable Amended Return circle), (2) Form D-400 Schedule AM, and (3) any applicable schedules (e.g., Form D-400 Schedule S, Form D-400 Schedule A, and Form D-400TC). An amended return requesting a refund must be filed within the statute of limitations for refunds.

If a taxpayer files an amended return with the Internal Revenue Service that contains an adjustment that would increase the amount of State tax payable, the taxpayer must file an amended North Carolina return within six months of filing the federal amended return. If the taxpayer does not timely file the amended North Carolina return, the Department may propose an assessment within three years from the date the return was due to be filed or three years from the date the federal amended return was filed with the Internal Revenue Service, whichever is later. The date the federal amended return was filed is presumed to be the date recorded by the Internal Revenue Service. If a taxpayer files an amended return with the Internal Revenue Service that contains an adjustment that would decrease the amount of State tax payable, the taxpayer may file an amended North Carolina return subject to the requirements of G.S. § 105-241.6.

If the Internal Revenue Service makes changes to an individual's federal return, the individual must report the changes to the State by filing an amended return within six months from the date the report from the Internal Revenue Service is received by the taxpayer. If an individual does not amend the State return to reflect the federal changes and the Department receives the report from the Internal Revenue Service, an assessment may be made by the Department within three years from the date of receipt of the report, and the individual's right to any refund which might have been due by reason of the change is forfeited.

For more information on filing an amended tax return within the statute of limitations, see G.S. § 105-159, G.S. § 105-241.6, G.S. § 105-241.7, G.S. § 105-241.8, G.S. § 105-241.9, and the Department's Important Notice dated July 13, 2016. Additional guidance is also available in Statute of Limitations and Federal Determinations.

8. Tax Rate

For tax year 2025, the North Carolina individual income tax rate is 4.25%. For more information, see Tax Rate Schedules.

Reference: G.S. § 105-153.7.

9. Time and Place for Filing

The due date for filing a calendar year end individual income tax return is April 15th of each year. For taxpayers reporting on a fiscal year end (a tax year ending on the last day of any month other than December), the due date for filing an individual income tax return is the 15th day of the fourth month following the close of the fiscal year. For information on when a document is considered timely filed if the due date falls on a Saturday, Sunday, or legal holiday, see Departmental Directive TA-16-1 and Departmental Directive TA-18-1.

Reference: G.S. § 105-155; G.S. § 105-263.

II. Filing Requirements

1. General

The minimum gross income filing requirements under North Carolina law are different from the filing requirements under the Internal Revenue Code because North Carolina law does not allow the same standard deduction amount as the Internal Revenue Code.

Reference: 17 NCAC 06B .0109.

2. Individuals Required to File a North Carolina Individual Income Tax Return

The following individuals are required to file a 2025 North Carolina individual income tax return:

a. Every resident of North Carolina whose gross income for the taxable year exceeds the amount shown in the Filing Requirements Chart for Tax Year 2025 in subsection 3 for the individual's filing status.

b. Every part-year resident who received income while a resident of North Carolina or who received income while a nonresident that was (1) attributable to the ownership of any interest in real or tangible personal property in North Carolina, or (2) derived from a business, trade, profession, or occupation carried on in North Carolina, or (3) derived from gambling activities in North Carolina and whose total gross income for the taxable year exceeds the amount shown in the Filing Requirements Chart for Tax Year 2025 in subsection 3 for the individual's filing status.

c. Every nonresident who received income for the taxable year from North Carolina sources that was (1) attributable to the ownership of any interest in real or tangible personal property in North Carolina, or (2) derived from a business, trade, profession, or occupation carried on in North Carolina, or (3) derived from gambling activities in North Carolina and whose total gross income from all sources both inside and outside of North Carolina for the taxable year exceeds the amount shown in the Filing Requirements Chart for Tax Year 2025 in subsection 3 for the individual's filing status. For nonresident businesses and employees engaged in disaster relief work at the request of a critical infrastructure company, see Critical Infrastructure Disaster Relief Work.

   Reference: G.S. § 105-153.8.

3. Minimum Gross Income Filing Requirements

Resident individuals who have gross income that exceeds the North Carolina standard deduction must file a North Carolina individual income tax return. Nonresident individuals who have gross income that exceeds the North Carolina standard deduction and receive gross income derived from North Carolina sources must file a North Carolina individual income tax return. The following Filing Requirements Chart shows the minimum gross income filing requirements for tax year 2025.

Note: If an individual was not required to file a federal income tax return but had total gross income inside and outside North Carolina that exceeds the amount shown in the Filing Requirements Chart for Tax Year 2025 for the individual's filing status, a pro forma federal income tax return must be completed and attached to the North Carolina individual income tax return to show how the federal adjusted gross income and deductions were determined.

Filing Requirements Chart for Tax Year 2025	
Filing Status	**A State Return is Required if Federal Gross Income Exceeds**
Single	$ 12,750
Married - Filing Joint Return	$ 25,500
Married - Filing Separate Return if Spouse Does Not Claim NC Itemized Deductions	$ 12,750
Married - Filing Separate Return if Spouse Claims NC Itemized Deductions	$ 0
Head of Household	$ 19,125
Qualifying Widow(er) with Dependent Child (Surviving Spouse)	$ 25,500
Nonresident Alien (regardless of filing status)	$ 0

Reference: G.S. § 105-153.8(a).

4. Joint Returns

a. Filing a Joint Return

G.S. § 105-153.8(e) requires two lawfully married individuals to file a joint North Carolina individual income tax return if:

a. The individuals file a joint federal income tax return, and

b. Each individual is independently required to file a North Carolina individual income tax return because that individual is either a resident of North Carolina or has North Carolina taxable income.

G.S. § 105-153.8(f) allows two lawfully married individuals who file a joint federal income tax return two options for filing a North Carolina individual income tax return if only one spouse is required to file a North Carolina individual income tax return.

When only one spouse is required to file a North Carolina individual income tax return, that spouse may file their North Carolina individual income tax return either:

a. Jointly under the provisions of G.S. § 105-153.8(e) based on the filing status of married, filing jointly/surviving spouse, or

b. Separately based on the filing status of married, filing separately. See Joint Federal Return, Separate State Returns for more information.

Note: Once a joint North Carolina individual income tax return is properly filed with the Department for a tax year, neither spouse can choose to separately file a North Carolina individual income tax returns for that tax year.

b. Joint and Several Liability for Tax Due

Individuals who file a joint North Carolina individual income tax return are treated as one taxpayer for the purpose of determining tax due. Each individual who files a joint income tax return is jointly and severally liable for the tax, reduced by the sum of all credits allowable including tax payments made by or on behalf of each individual. However, if one of the individuals qualifies for federal income tax relief pursuant to IRC section 6015, that individual is not liable for the corresponding North Carolina income tax.

c. Refunds

By filing a joint individual income tax return, each individual has expressly agreed that if the amount of the payments made by them with respect to the taxes for which they are liable, including withheld and estimated taxes, exceeds the total of the taxes due, any refund due may be made payable to both individuals jointly or, if either is deceased, to the surviving spouse.

d. Joint Federal Return, Separate North Carolina Returns

When an individual files a federal income tax return jointly with their spouse but properly files a North Carolina individual income tax return separately from their spouse, the individual must either:

a. Attach a pro-forma federal income tax return to the North Carolina individual income tax return calculating the individual's adjusted gross income ("AGI") using the federal filing status, married filing separately, or

b. Attach an explanatory schedule to the North Carolina individual income tax return showing the computation of that individual's AGI. An individual who submits an explanatory schedule must attach a copy of their spouse's joint federal income tax return if the federal income tax return reflects an address outside North Carolina.

The purpose of the pro-forma federal income tax return and the explanatory schedule is to show how AGI for the individual who is required to file a North Carolina individual income tax return would be determined on a separate federal income tax return. Thus, the pro-forma federal income tax return and the explanatory schedule must report only the income and the deductions for the individual who is required to file a North Carolina individual income tax return. **Note**: Itemized nonbusiness deductions of a married couple may be claimed by the individual filing the North Carolina individual income tax return only if that individual was obligated to pay the items and actually paid the amount during the year. In the case of a joint obligation (such as mortgage interest and real estate taxes), the deduction is allowable to the individual required to file a North Carolina individual income tax return only if that individual actually paid the item.

Reference: G.S. § 105-153.8(e); G.S. § 105-153.8(f); 17 NCAC 06B .0112.

5. Legal Separation and Head of Household Filing Status

Under federal law, an individual who is legally separated from a spouse under a decree of divorce or of separate maintenance shall not be considered as married. A separation agreement authorized under G.S. § 52-10.1 does not constitute a legal separation under a decree of divorce or of separate maintenance within the meaning of the Code.

For North Carolina income tax purposes, the definition of "head of household" incorporates by reference IRC section 7703. IRC section 7703 expands eligibly to claim the head of household filing status to certain married individuals living apart (including those without a decree of divorce or separate maintenance). To the extent an individual meets the requirements of IRC section 7703 and so qualifies for head of household filing status for federal purposes, the individual will also qualify for the head of household filing status for North Carolina purposes.

Reference: G.S. § 105-153.3.

III. Computation of North Carolina Taxable Income

1. General

The starting point for determining North Carolina taxable income is federal adjusted gross income as determined under the Code as of a date set by the North Carolina General Assembly.

A taxpayer must first determine federal adjusted gross income before beginning the North Carolina individual income tax return. If the taxpayer is not filing a federal income tax return, the taxpayer must complete a schedule showing the computation of federal adjusted gross income and deductions. The taxpayer must attach the schedule to the North Carolina income tax return.

Reference: G.S. § 105-153.4; G.S. § 105-228.90(b)(7); 17 NCAC 06B.0014.

2. Additions to Federal Adjusted Gross Income

Federal adjusted gross income must be increased by certain additions to the extent the amounts are not included in federal adjusted gross income. A taxpayer must report the additions by completing Part A of Form D-400 Schedule S, North Carolina Supplemental Schedule. For more information about the additions required on the 2025 North Carolina individual income tax return, review the 2025 Form D-401, Individual Income Tax Instructions. These additions include the following:

a. Interest received from notes, bonds, and other obligations of states other than North Carolina and their political subdivisions. Under this statute, an individual is required to add the total of such interest to federal adjusted gross income even though the individual may have incurred expenses in earning the interest. This addition includes that portion of an exempt interest dividend from a regulated investment company (mutual fund) that represents interest on direct obligations of states other than North Carolina and their political subdivisions. For more information, see Taxable Status of Distributions from Regulated Investment Companies.

b. A shareholder of an S corporation is required to make an addition to federal adjusted gross income for the shareholder's share of built-in gains tax that the S corporation paid for federal income tax purposes. Because the income subject to the built-in gains tax is taxed at both the S corporation and shareholder level for federal income tax purposes, federal law allows the shareholder to deduct the shareholder's pro rata share of the built-in gains tax to provide relief from double taxation. North Carolina does not impose a built-in gains tax; therefore, there is no double taxation for State income tax purposes.

c. An individual who is a shareholder of an S corporation or a partner in a partnership is required to make an addition to federal adjusted gross income for the individual's share of state, local, or foreign income taxes deducted under section 164 of the Code.

d. The amount by which the basis of property for federal purposes exceeds the basis for State purposes must be added to adjusted gross income in the year that the property is disposed of.

e. The amount required to be added under G.S. § 105-153.6 when the State decouples from federal accelerated depreciation and expensing.

   1. Federal Accelerated (Bonus) Depreciation

      A taxpayer is required to add to federal adjusted gross income 85% of the amount allowed as a bonus depreciation deduction under section 168(k) or 168(n) of the Code for property placed in service during the year. This adjustment does not result in a difference in basis of the affected assets for State and federal income tax purposes.

      A percentage of the federal bonus depreciation allowed under sections 168(k) and (n) of the Code is required as an add-back to federal adjusted gross income. If an addition is required and made by a taxpayer, the taxpayer may deduct 20% of the amount of the bonus depreciation add-back in the first five taxable years following the year the taxpayer is required to include the add-back in income.

      For further guidance, see Bonus Asset Basis.

   2. Section 179 Expensing Limitations

      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. For tax year 2013 and forward, the North Carolina Dollar Limitation is $25,000 and the North Carolina Investment Limitation is $200,000.

      In addition, a taxpayer placing section 179 property in service during these years is required to add to federal adjusted gross income 85% of the federal section 179 deduction in excess of the amount allowed using the North Carolina limits shown in the above table. If an addition is required and made by a taxpayer, the taxpayer may deduct 20% of the section 179 add-back in the first five taxable years following the year the taxpayer is required to include the add-back in income.

      For further guidance, see Income Tax Adjustments for Code Section 179 Expenses.

f. The amount of federal net operating loss deducted on the federal return. See Net Operating Losses for additional information.

g. The amount contributed to an account in the Parental Savings Trust Fund of the State Education Assistance Authority to the extent the amount was deducted in a prior taxable year under G.S. § 105-134.6(d)(4) if this amount is withdrawn from the Parental Savings Trust Fund and not used to pay for the qualified expenses of the designated beneficiary or rolled into a qualified 529 ABLE account. An individual does not have to add to federal adjusted gross income the amount of funds withdrawn if the funds are used for a purpose allowed under section 529 of the Code, as amended by the federal Tax Cuts and Jobs Act of 2017.

h. Section 1400Z-2 of the Code includes a provision that provides a tax benefit to a qualified investor who invests capital gains into qualifying Opportunity Zones. North Carolina did not conform to the Code with respect to the following:

   1. A taxpayer is required to add to federal adjusted gross income the amount of gain temporarily excluded from the taxpayer's gross income under section 1400Z-2 of the Code because the gain was reinvested into a qualified Opportunity Fund as defined under the Code. The adjustment made to federal adjusted gross income does not result in a difference in basis of the affected assets for State and federal income tax purposes.

   2. A taxpayer is allowed to deduct the amount of gain included in federal adjusted gross income under section 1400Z-2 of the Code to the extent the same income was included in the taxpayer's North Carolina taxable income in a prior tax year.

   3. A taxpayer is required to add to federal adjusted gross income the amount of gain permanently excluded from the taxpayer's gross income 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 10 years. For more information, see the Department's Important Notice issued on August 21, 2018.

i. The amount of the discharge of qualified principal residence indebtedness excluded from federal gross income under section 108 of the Code.

   The Consolidated Appropriations Act, 2021, extended through tax year 2025 the exclusion from gross income for the discharge of qualified principal residence indebtedness under section 108 of the Code. North Carolina did not adopt this provision of the Code. **Note:** If the taxpayer is insolvent, as defined in section 108(d)(3) of the Code, then the addition required under this subdivision is limited to the amount of discharge of qualified principal residence indebtedness excluded from adjusted gross income under section 108(a)(1)(E) of the Code that exceeds the amount of discharge of indebtedness that would have been excluded under section 108(a)(1)(B) of the Code.

j. The amount excluded from the taxpayer's gross income for payment by an employer of principal or interest on any qualified education loan, as defined in section 221(d)(1) of the Code, incurred by the taxpayer for education of the taxpayer.

   The Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act") excluded certain employer payments of student loans under Code section 127(c) from gross income for tax year 2020. The Consolidated Appropriations Act, 2021, extended this exclusion through 2025. North Carolina did not adopt this provision of the Code.

k. 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 North Carolina income tax.

l. The amount excluded from the taxpayer's gross income for the discharge of a student loan under Code section 108(f)(5). For tax years 2021 through 2025, a taxpayer who does not include in gross income any amount of discharged student loan debt that would have been included in gross income but for the special provision included in the American Rescue Plan Act must add the amount excluded when calculating North Carolina taxable income.

   The statute also limits the addition for the discharge of a student loan for taxpayers who are insolvent (as defined in Code section 108(d)(3)) ("Insolvent Taxpayer"). For tax years 2021 through 2025, an Insolvent Taxpayer must add to AGI the amount of student loan debt discharged under Code section 108(f)(5) to the extent the amount of discharge exceeds the amount of discharge of indebtedness that would have been excluded under Code section 108(a)(1)(B).

   For more information, see the Department's Important Notice: State Tax Treatment of Federal Student Loan Forgiveness, dated December 14, 2022.

m. The amount of the taxpayer's pro rata share of loss attributable to North Carolina from a Taxed S Corporation to the extent the loss was included in the Taxed S Corporation's North Carolina taxable income and the taxpayer's federal adjusted gross income. See Taxed Pass-Through Entities for more information.

n. The amount of the taxpayer's distributive share of loss attributable to North Carolina from a Taxed Partnership to the extent the loss was included in the Taxed Partnership's North Carolina taxable income and the taxpayer's federal adjusted gross income. See Taxed Pass-Through Entities for more information.

Reference: G.S. § 105-153.5; G.S. § 105-153.6.

3. Deductions from Federal Adjusted Gross Income

Federal adjusted gross income may be decreased by the following deductions to the extent the amounts are included in federal adjusted gross income. A taxpayer may report the deductions by completing Part B of Form D-400 Schedule S, North Carolina Supplemental Schedule. For more information about the deductions allowed on the 2025 North Carolina individual income tax return, review the 2025 Form D-401, Individual Income Tax Instructions. These deductions include the following:

a. Interest received from notes, bonds, and other obligations of any of the following:

   1. The United States or its possessions.

      Interest earned from obligations that are merely backed or guaranteed by the United States Government will not qualify for deduction from an individual's income. The deduction from income will not apply to distributions which represent gain from the sale or other disposition of the securities, nor to interest paid in connection with repurchase agreements issued by banks and savings and loan associations. The deduction will not apply to any portion of a distribution from an individual retirement account (IRA). For more information, including examples, see Interest from Obligations of the United States.

2. The State of North Carolina or any of its political subdivisions. For more information, including examples, see Income from North Carolina Obligations.

3. A nonprofit educational institution organized or chartered under North Carolina law.

4. A hospital authority created under G.S. § 131E-17.

b. Gain from the disposition of obligations issued before July 1, 1995, if North Carolina law under which the obligations were issued specifically exempts the interest or gain. (With respect to North Carolina obligations issued after July 1, 1995, the income tax treatment of gains from the sale or disposition of such obligations is the same for federal and State purposes.)

c. Taxable portion of Social Security benefits received under Title II of the Social Security Act and any Tier I or Tier II Railroad Retirement benefits received under the Railroad Retirement Act of 1937.

d. Refunds of state, local, and foreign income taxes.

e. Income earned or received by an enrolled member of a federally recognized Indian tribe if such income is derived from activities on a federally recognized Indian reservation while the member resided on the reservation. Intangible income having a situs on the reservation and retirement income associated with activities on the reservation are considered income derived from activities on the reservation.

f. The amount by which the basis of property for State purposes exceeds the basis for federal purposes must be deducted from adjusted gross income in the year that the property is disposed of. The deduction can be claimed only in the year in which the property is disposed.

g. The amount received during the taxable year from one or more State, local, or federal government retirement plans to the extent the amount is exempt from North Carolina individual income tax pursuant to a court order in settlement of any of the following cases:

- Bailey v. State, 92 CVS 10221, 94 CVS 6904, 95 CVS 6625, 95 CVS 8230.
- Emory v. State, 98 CVS 0738.
- Patton v. State, 95 CVS 04346.

For more information, see Bailey Settlement.

h. The amount received from the United States government for retirement payments for service in the uniformed services of the United States made to a retired member that served at least 20 years or medically retired under 10 U.S.C. Chapter 61. This deduction does not apply to severance pay received by a member due to separation under 10 U.S.C. Chapter 61. The deduction is also available for a beneficiary of an eligible retired member for payments made to the beneficiary from a Plan defined in 10 U.S.C. § 1447. Amounts deducted under this subdivision may not also be deducted under G.S. § 105-153.5(b)(5).

i. An amount equal to 20% of the bonus depreciation deduction added to the taxpayer's federal adjusted gross income on their 2019, 2020, 2021, 2022 and 2023 North Carolina individual income tax return. **Note:** An individual who receives a Form NC K-1 from an S Corporation or a partnership that reports a deduction for bonus depreciation is only entitled to take the deduction if the individual made the corresponding addition for bonus depreciation on the individual's income tax return in a previous year.

j. An amount equal to 20% of the section 179 expense deduction added to the taxpayer's federal adjusted gross income on their 2019, 2020, 2021, 2022 and 2023 North Carolina individual income tax return. For more information, see Income Tax Adjustments for Code Section 179 Expense.

k. The amount by which a deduction for an ordinary and necessary business expense was required to be reduced or was not allowed in arriving at federal adjusted gross income because the taxpayer claimed a federal tax credit against its federal income tax liability for those expenses instead of a deduction. The deduction is allowed only to the extent that a similar credit is not allowed against the North Carolina income tax liability for the expenses.

l. The amount of gain included in federal adjusted gross income under section 1400Z-2 of the Code to the extent the same income was included in the taxpayer's North Carolina taxable income in a prior tax year. For more information, see the Department's Important Notice issued on August 21, 2018.

m. The amount deposited during the taxable year to a personal education student account ("PESA") under Article 41 of Chapter 115C of the General Statutes, "Personal Education Student Accounts for Children with Disabilities," to the extent the deposit was included in adjusted gross income.

n. The amount paid to a taxpayer during the taxable year from the State Emergency Response and Disaster Relief Reserve Fund for hurricane relief or assistance. A taxpayer may not deduct any payment made to the taxpayer for goods or services provided by the taxpayer.

o. The amount received by a taxpayer as an economic incentive pursuant to G.S. 143B-437.012 or Part 2G or Part 2H of Article 10 of Chapter 143B of the General Statutes.

p. An amount equal to 20% of the amount added to the taxpayer's AGI pursuant to G.S. § 105-153.5(c2)(8), (9), or (10) for net operating loss carrybacks.

Note: G.S. § 105-153.5(c2)(14) requires a taxpayer to have made the addition to AGI under G.S. § 105-153.5(c2)(8), (9), or (10) in order to qualify for this deduction. A taxpayer whose North Carolina individual income tax return does not reflect the corrected AGI and required addition under G.S. § 105-153.5(c2)(8), (9), or (10) will not be eligible for the corresponding deduction under G.S. § 105-153.5(c2)(14).

q. An amount equal to 20% of the amount added to the taxpayer's AGI in tax years 2018 through 2020 pursuant to G.S. § 105-153.5(c2)(12) for excess business losses.

r. An amount equal to 20% of the amount added to the taxpayer's AGI pursuant to G.S. § 105-153.5(c2)(13) in tax years 2019 and 2020 for excess net operating loss carryforward deductions.

s. The amount received by a taxpayer for the following payments received from North Carolina to the extent the income was included in the taxpayer's AGI:

1. The Business Recovery Grant Program.
2. The ReTOOLNC grant program for recovery from the economic impacts of the COVID-19 pandemic.
3. 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.

t. The amount of North Carolina net operating loss allowed under the provisions of G.S. § 105-153.5A. See Net Operating Losses for more information.

u. The amount of the taxpayer's pro rata share of income attributable to North Carolina from a Taxed S Corporation to the extent the income was included in the Taxed S Corporation's North Carolina taxable income and the taxpayer's AGI. See Taxed Pass-Through Entities for more information.

v. The amount of a resident taxpayer's pro rata share of income not attributable to North Carolina from an S Corporation to the extent the income (1) was included in the S Corporation's taxable income in another state or the District of Columbia, (2) was subject to an entity-level tax levied on the aggregate pro rata share of the S Corporation's income allocable to one or more of its shareholders, and (3) was included in the taxpayer's AGI as modified by North Carolina law. An S Corporation is taxable in another state or the District of Columbia if the S Corporation's business activity in that state or the District of Columbia subjects the S Corporation to a net income tax, or a tax measured by net income. See Taxed Pass-Through Entities for more information.

w. The amount of the taxpayer's distributive share of income attributable to North Carolina from a Taxed Partnership to the extent the income was included in the Taxed Partnership's North Carolina taxable income and the taxpayer's AGI. See Taxed Pass-Through Entities for more information.

x. The amount of a resident taxpayer's share of distributive income not attributable to North Carolina from a partnership to the extent the income (1) was included in the partnership's taxable income in another state or the District of Columbia, (2) was subject to an entity-level tax levied on the aggregate distributive share of the partnership's income allocable to one or more of its partners, and (3) was included in the taxpayer's AGI as modified by North Carolina law. A partnership is taxable in another state or the District of Columbia if the partnership's business activity in that state or the District of Columbia subjects the partnership to a net income tax or a tax measured by net income. See Taxed Pass-Through Entities for more information.

Reference: G.S. § 105-153.5; G.S. § 105-153.6; 17 NCAC 06B .0116.

4. North Carolina Child Deduction

G.S. § 105-153.5(a1) allows a taxpayer a deduction for each qualifying child for whom the taxpayer is allowed a federal child tax credit under IRC § 24. The deduction amount for tax year 2025 is equal to the amount listed in the following table based on the taxpayer's AGI, as calculated under the Code:

Reference: G.S. § 105-153.5(a1).

Filing Status	AGI	Deduction Amount
Married, filing jointly/Qualifying Widow(er)/Surviving Spouse	Up to $40,000	$3,000
	Over $40,000 Up to $60,000	$2,500
	Over $60,000 Up to $80,000	$2,000
	Over $80,000 Up to $100,000	$1,500
	Over $100,000 Up to $120,000	$1,000
	Over $120,000 Up to $140,000	$500
	Over $140,000	$0
Head of Household	Up to $30,000	$3,000
	Over $30,000 Up to $45,000	$2,500
	Over $45,000 Up to $60,000	$2,000
	Over $60,000 Up to $75,000	$1,500
	Over $75,000 Up to $90,000	$1,000
	Over $90,000 Up to $105,000	$500
	Over $105,000	$0
Single/Married, filing separately	Up to $20,000	$3,000
	Over $20,000 Up to $30,000	$2,500
	Over $30,000 Up to $40,000	$2,000
	Over $40,000 Up to $50,000	$1,500
	Over $50,000 Up to $60,000	$1,000
	Over $60,000 Up to $70,000	$500
	Over $70,000	$0

5. North Carolina Standard Deduction

In calculating North Carolina taxable income, an individual may deduct from federal adjusted gross income either the North Carolina standard deduction amount or North Carolina itemized deductions, whichever is applicable.

The North Carolina standard deduction amount for most individuals for tax year 2025 can be found in the following chart. However, the North Carolina standard deduction amount is zero for persons who are not eligible for the federal standard deduction. An individual is not eligible for the federal standard deduction if: (1) the individual is married but files a federal income tax return separately from their spouse and their spouse itemizes deductions on the spouse's federal income tax return, (2) the individual is a nonresident alien, or (3) the individual files a short-year federal income tax return because of a change in accounting period. In general, a nonresident alien is an alien (not a U.S. citizen) who has not passed the green card test or the substantial presence test. *(For more information on the green card test and the substantial presence test, see IRS Publication 519, U.S. Tax Guide for Aliens).*

N.C. Standard Deduction Chart for Tax Year 2025	
If your filing status is:	**Your standard deduction is:**
Single	$ 12,750
Married - Filing Joint Return/ Qualifying Widow(er)/Surviving Spouse	$ 25,500
Married - Filing Separate Return if Spouse Does Not Claim NC Itemized Deductions	$ 12,750
Married - Filing Separate Return if Spouse Claims NC Itemized Deductions	$ 0
Head of Household	$ 19,125

Reference: G.S. § 105-153.5(a)(1).

6. North Carolina Itemized Deductions

North Carolina itemized deductions are not identical to federal itemized deductions and are subject to certain limitations. Individuals who claim N.C. itemized deductions must complete Form D-400 Schedule A, and attach the schedule to the North Carolina individual income tax return, Form D-400.

For tax year 2025, the North Carolina itemized deductions are as follows:

a. Qualified Mortgage Interest and Real Estate Property Taxes.
The sum of qualified home mortgage interest and real estate property taxes claimed under sections 163(h) and 164 of the Code are allowed as an itemized deduction. However, the sum of qualified home mortgage interest and real estate property taxes may not exceed \$20,000. For spouses filing as married filing separately or married filing jointly, the total home mortgage interest and real estate taxes claimed by both spouses combined may not exceed \$20,000. For spouses filing as married filing separately with a joint obligation for home mortgage interest and real estate taxes, the deduction for these items is allowable to the spouse who actually paid them. If the amount of the home mortgage interest and real estate taxes paid by both spouses exceeds \$20,000, these deductions must be prorated based on the percentage paid by each spouse. For joint obligations paid from joint accounts, the proration is based on the income reported by each spouse for that taxable year.

b. Charitable Contributions

Charitable contributions allowed as a deduction under section 170 of the Code are allowed.

Note: For tax years 2020 and 2021, North Carolina decoupled from the temporary increase in the charitable contribution deduction limits for certain contributions allowed under section 170 of the Code. Consequently, an individual who claimed North Carolina itemized deductions could only deduct qualified contributions up to 60% of the individual's AGI and charitable contributions of food up to 15% of AGI. For taxable years beginning on or after January 1, 2021, a taxpayer may only carry forward the charitable contributions from taxable years 2020 and 2021 that exceed the applicable percentage limitation for the 2020 and 2021 taxable years allowed under G.S. § 105-153.5(a)(2)a.

c. Medical and Dental Expenses.

G.S. § 105-153.5(a)(2)(c) provides that an individual is allowed a North Carolina itemized deduction for medical and dental expenses for the amount allowed as a deduction under section 213 of the Code for that taxable year.

d. Claim of Right Deduction.

Under the federal "Claim of Right" Doctrine, a taxpayer who receives income under a claim of right and without restriction on the use or disposition of the income is taxed on that income in the year of receipt even though the right to retain the income is not yet fixed or the taxpayer may later be required to return it.

Under federal law, if a taxpayer is required to repay an amount previously included in the federal return in an earlier year, the taxpayer may be able to deduct the amount repaid or take a tax credit. The amount of the repayment determines the options available to the taxpayer. For further guidance, see federal Publication 525.

For North Carolina tax purposes, a taxpayer is allowed a deduction for the repayment to the extent the repayment is not deducted in arriving at the taxpayer's adjusted gross income in the current taxable year. If the repayment is more than $3,000, the deduction is the amount of the repayment. If the repayment is $3,000 or less, the deduction is the amount of repayment less 2% of adjusted gross income.

For information on how to compute the claim of right deduction, see "Repayment of Claim of Right Income" and "Repayment of Claim of Right Worksheet" located in the North Carolina Individual Income Tax Instructions (Form D-401).

No deduction is allowed if the taxpayer calculates the federal income tax in the year of repayment under the provisions of section 1341(a)(5) of the Code. In that case, a taxpayer will recover the tax previously paid on the repaid income under G.S. § 105-266.2.

For federal income tax purposes, if the amount of repayment is more than $3,000, a taxpayer may be able to deduct the amount repaid in the year of repayment or elect to take a credit on the federal return. For more information on the claim of right income credit, see Claim of Right Income Credit.

Reference: G.S. § 105-153.5(a)(2).

IV. Nonresident and Part-Year Resident

1. Definition of Resident

G.S. § 105-153.3(15) defines a resident as "an individual who is domiciled in this State at any time during the taxable year or who resides in this State during the taxable year for other than a temporary or transitory purpose."

In the absence of convincing proof to the contrary, an individual who is present within North Carolina for more than 183 days during the taxable year is presumed to be a resident for income tax purposes, but the absence of an individual from the State for more than 183 days raises no presumption that the individual is not a resident.

A resident who moves from the State during a taxable year is considered a resident of North Carolina until the individual has both established a definite domicile elsewhere and abandoned any domicile in North Carolina. A taxpayer may have several places of abode in a year, but at no time can an individual have more than one domicile. A mere intent or desire to make a change in domicile is not enough; voluntary and positive action must be taken. The fact of marriage does not raise any presumption as to domicile or residence.

Listed below are some of the factors to be considered in determining the legal residence of an individual for income tax purposes. As implied by the list of factors below, an individual's legal state of residence is reflected more by the routine events of life rather than events such as voting or obtaining a driver's license which may occur every four to eight years.

- Place of birth of the taxpayer, the taxpayer's spouse, and the taxpayer's children.
- Permanent residence of the taxpayer's parents.
- Family connections and close friends.
- Address used for federal tax returns, military purposes, passports, driver's license, vehicle registrations, insurance policies, professional licenses or certificates, subscriptions for newspapers, magazines, and other publications, and monthly statements for credit cards, utilities, bank accounts, loans, insurance, or any other bill or item that requires a response.
- Civic ties, such as church membership, club membership, or lodge membership.
- Professional ties, such as licensure by a licensing agency or membership in a business association.
- Payment of state income taxes.
- Place of employment or, if self-employed, place where business is conducted.

- Location of healthcare providers, such as doctors, dentists, veterinarians, and pharmacists.

- Voter registration and ballots cast, whether in person or by absentee ballot.

- Occasional visits or spending one's leave "at home" if a member of the armed services.

- Ownership of a home, insuring a home as a primary residence, or deferring gain on the sale of a home as a primary residence.

- Location of pets.

- Attendance of the taxpayer or the taxpayer's children at State supported colleges or universities on a basis of residence–taking advantage of lower tuition fees.

- Location of activities for everyday "hometown" living, such as grocery shopping, haircuts, video rentals, dry cleaning, fueling vehicles, and automated banking transactions.

- Utility usage, including electricity, gas, telecommunications, and cable television.

Listed below are some of the factors to consider in determining when residency may have changed:

- Selling a house and buying a new one.

- Directing U.S. Postal Service to forward mail to a new address.

- Transferring family medical records to a new health care provider.

- Notifying senders of statements, bills, subscriptions, and similar items of new address.

- Registering a vehicle in a new jurisdiction.

- Transferring memberships for church, health club, lodge, or similar activity.

- Applying for professional certifications in a jurisdiction.

A legal resident of North Carolina serving in the United States Armed Forces is liable for North Carolina income tax and North Carolina income tax should be withheld from military pay whether the individual is stationed in this State or in some other state or country.

An individual who enters military service while a resident of North Carolina is presumed to be a resident of this State for income tax purposes. Residency in this State is not abandoned until a definite residence is established elsewhere. To change residency, the servicemember must not only be present in the new location with the intention of making the new location the servicemember's domicile but must factually establish that the servicemember has done so. See Servicemembers and Military Spouses for more information.

Reference: G.S. § 105-153.4(b); 17 NCAC 06B .3901.

2. Definition of a Nonresident

G.S. § 105-153.3(11) defines a "nonresident individual" as "an individual who is not a resident of [North Carolina]." The term includes an individual:

a. Who resides in North Carolina for a temporary or transitory purpose and is, in fact, a domiciliary resident of another state or country; or

b. Who does not reside in North Carolina but has income from sources within North Carolina and is, in fact, a domiciliary resident of another state or country.

3. Servicemember and Military Spouse

a. Servicemember

Under the Servicemembers Civil Relief Act, a member of the Armed Services who is domiciled in another state and is stationed in North Carolina by virtue of military orders is not subject to North Carolina income tax on military service pay. Other income from employment, a business, or tangible property in North Carolina is subject to North Carolina income tax.

b. Military Spouse

The Servicemembers Civil Relief Act provides that a spouse shall neither lose nor acquire domicile or residence in a state when the spouse is present in the state solely to be with the servicemember in compliance with the servicemember's military orders.

The income earned for services performed in North Carolina by a spouse of a servicemember who is legally domiciled in a state other than North Carolina is not subject to North Carolina income tax if both of the following conditions are met:

1. The servicemember is present in North Carolina in compliance with military orders, and

2. The spouse is in North Carolina solely to be with the servicemember.

Note: North Carolina sourced income unrelated to personal service income earned by the spouse (such as rental property income or income from the gain on the sale of North

Carolina property) is subject to North Carolina income tax regardless of the state of domicile of the spouse.

c. Domicile Election under The Veterans Auto and Education Improvement Act of 2022

The Veterans Auto and Education Improvement Act of 2022 ("VAEIA") authorizes both the servicemember and spouse to elect to use any of the following as the state of domicile for income tax purposes:

1. The residence or domicile state of the servicemember;
2. The residence or domicile state of the spouse; or
3. The permanent duty station of the servicemember.

The servicemember and the spouse may each independently make the election and are not required to elect the same state for North Carolina income tax purposes. A servicemember and spouse make the election by filing their North Carolina individual income tax return(s) as a North Carolina resident or nonresident.

Note: North Carolina sourced income unrelated to personal service income earned by the servicemember or spouse (such as rental property income or income from the gain on the sale of North Carolina property) is subject to North Carolina income tax regardless of any election made under VAEIA.

There is no presumption as to the residence of a spouse of a servicemember because of marriage. Legal residence will be determined based on the facts in each case.

Example 1. *Servicemember joined the military in 2024 while domiciled in North Carolina. Servicemember's permanent duty station is located in Texas for the 2025 tax year. Servicemember does not elect to change North Carolina domicile.*

Servicemember's military income will be subject to North Carolina income tax.

Example 2. *Servicemember joined the military in 2024, while domiciled in North Carolina. Servicemember's permanent duty station is located in Texas for the 2025 tax year. Servicemember elects to make Texas his domicile for income tax purposes for 2025.*

Servicemember's military income will not be subject to North Carolina income tax.

Example 3. *Servicemember and spouse were married in 2018 Servicemember is domiciled in Florida. Spouse is also domiciled in Florida. Servicemember is stationed in North Carolina in June 2025. Spouse moves to North Carolina in June 2025 solely to be with servicemember. Spouse is employed and earns wages in North Carolina during 2025.*

Spouse's wages are not subject to North Carolina income tax for tax year 2025 because the servicemember is present in North Carolina in compliance with military orders, the spouse is in North Carolina solely to be with the servicemember, and the spouse is not domiciled in North Carolina.

Example 4. *Servicemember and spouse were married in 2018. Servicemember is domiciled in Florida. Spouse is domiciled in Texas. Servicemember is stationed in North Carolina in January of 2025. Spouse moves to North Carolina in January 2025 solely to be with servicemember. Spouse is employed and earns wages in North Carolina during 2025.*

Spouse's wages are not subject to North Carolina income tax for tax year 2025 because the servicemember is present in North Carolina in compliance with military orders, the spouse is in North Carolina solely to be with the servicemember, and the spouse is not domiciled in North Carolina.

Example 5. *Servicemember and spouse were married in 2018. Servicemember was domiciled in California. Spouse was domiciled in New York. Servicemember is stationed in North Carolina in January of 2025. Spouse moves to North Carolina in January 2025 solely to be with servicemember. Spouse is employed and earns wages in North Carolina during 2025. Servicemember and spouse elect to use North Carolina as their domicile for 2025.*

Spouse's wages are subject to North Carolina income tax for tax year 2025 because spouse's domicile is North Carolina during 2025.

Example 6. *Servicemember and spouse were married in 2020. Servicemember was domiciled in Texas. Spouse was domiciled in Florida. Servicemember is stationed in North Carolina in January of 2025. Spouse moves to North Carolina in January 2025 solely to be with servicemember. Spouse is employed and earns wages in North Carolina during 2025. Servicemember and spouse elect to use Florida as their domicile for 2025.*

Spouse's wages are not subject to North Carolina income tax for tax year 2025 because the servicemember is present in North Carolina in compliance with military orders, the spouse is in North Carolina solely to be with the servicemember, and the spouse is not domiciled in North Carolina.

Example 7. *Servicemember is domiciled in Florida and is stationed in North Carolina in July 2022. Servicemember and spouse meet in North Carolina in 2023 while spouse is a North Carolina resident and is employed and earning wages in North Carolina. Servicemember and spouse are married in North Carolina in December 2024 while spouse was domiciled in North Carolina. Spouse is employed and earns wages in North Carolina in 2025. Spouse elects to use the same residence as the servicemember (Florida) for state income tax purposes for 2025.*

For tax year 2025, spouse's wages are subject to North Carolina income tax because spouse is not in North Carolina solely to be with the servicemember. **Note:** While spouse's wages are subject to North Carolina income tax, certain intangible income of the spouse may not be subject to North Carolina income tax because spouse elected to use Florida as spouse's state of residence.

Reference: 17 NCAC 06B .3902; 50 U.S.C. § 4001.

4. Part-Year Resident

An individual who moves their domicile (legal residence) into or out of North Carolina during the tax year is a part-year resident.

Reference: G.S. § 105-153.4(c); 17 NCAC 06B .3903.

5. Taxable Income of a Nonresident

a. General

The taxable income of a nonresident subject to North Carolina income tax is determined by first calculating federal adjusted gross income as calculated under the Code, adjusted as provided under G.S. § 105-153.5 and G.S. § 105-153.6. The result is multiplied by the percentage obtained when dividing the portion of total federal gross income derived from North Carolina sources, as adjusted, by the total federal gross income, as adjusted. Importantly, the percentage may be over 100% if a taxpayer's North Carolina sourced income is greater than the taxpayer's total income from all sources.

Note: Only those North Carolina adjustments that relate to a taxpayer's gross income can be included when determining the taxpayer's proration percentage. See Schedule PN and Schedule PN-1 for additional information.

b. S Corporation Income

The amount of a shareholder's pro rata share of S Corporation income, as modified in G.S. 105-153.5 and G.S. 105-153.6, that is includable in the numerator of the proration percentage is the shareholder's pro rata share of the S Corporation's income attributable to the State, as that term is defined under G.S. 105-131(b)(4). S Corporation income means the entire gross income of the business less all expenses, taxes, interest, and other deductions allowable under the Code that were incurred in the operation of the business.

c. Partnership Income

The amount of a partner's distributive share of partnership income, as modified in G.S. 105-153.5 and G.S. 105-153.6, that is includable in the numerator of the proration percentage is the partner's distributive share of partnership income as determined under the provisions of G.S. 105-130.4. Partnership income means the entire gross income of the business less all expenses, taxes, interest, and other deductions allowable under the Code that were incurred in the operation of the business.

d. Sole Proprietorship Income

The amount of sole proprietorship income, as modified in G.S. 105-153.5 and G.S. 105-153.6, that is includable in the numerator of the proration percentage is the income of the trade or business allocated and apportioned to North Carolina as determined under the provisions of G.S. 105-130.4. The income of the business means the entire gross income of the business less all expenses, taxes, interest, and other deductions allowable under the Code that were incurred in the operation of the business.

Reference: G.S. § 105-153.4.

6. Taxable Income of a Part-Year Resident

The taxable income of a part-year resident subject to North Carolina income tax is determined by first calculating federal adjusted gross income as calculated under the Code, adjusted as provided under G.S. § 105-153.5 and G.S. § 105-153.6. The result is multiplied by the percentage obtained when dividing the portion of total federal gross income received from all sources during the period the individual was a resident of North Carolina, plus any income received from North Carolina sources while a nonresident, as adjusted, by the total federal gross income, as adjusted. Importantly, the percentage may be over 100% if a taxpayer's North Carolina sourced income is greater than the taxpayer's total income from all sources.

If an individual has income from sources within another state or country while a resident of North Carolina and the other state or country taxes the individual on such income, the individual may be eligible to claim a tax credit for tax paid to the other state or country on the North Carolina income tax return.

Note: Only those North Carolina adjustments that relate to a taxpayer's gross income should be included when determining the taxpayer's proration percentage. See Schedule PN and Schedule PN-1 for additional information.

Reference: G.S. § 105-153.4; 17 NCAC 06B .3904.

7. Nonresident Member of a Professional Athletic Team

To determine the portion of an athlete's compensation for services rendered as a member of a professional athletic team during the taxable year that is considered North Carolina source income and included in the numerator of the fraction determined under G.S. § 105-153.4(b), the nonresident member of a professional athletic team multiplies the amount of total compensation for services rendered as a member of a professional athletic team during the taxable year by a fraction. The numerator of the fraction is the number of duty days spent in North Carolina rendering services for the team in any manner during the taxable year. The denominator is the total number of duty days spent both within and outside North Carolina during the taxable year.

Travel days that do not involve either a game, practice, team meeting, promotional caravan or other similar team activity are not considered duty days spent in North Carolina and compensation for those days is not included in the numerator of the fraction determined under G.S. § 105-153.4(b). However, such travel days are considered duty days spent within and outside North Carolina and compensation for those days is included in the denominator of the fraction determined under G.S. § 105-153.4(b).

Where the method of apportioning and allocating the compensation as described above produces substantially incorrect results, the Secretary of Revenue may require the member of a professional athletic team to apportion and allocate the compensation under another method prescribed by the Secretary as long as the prescribed method better reflects the compensation received for services performed in North Carolina. A nonresident member of a professional athletic team may request an alternative method to apportion and allocate the compensation, demonstrating that the method provided under this section produces substantially incorrect results. If the Secretary approves the alternative method, a copy of the Secretary's written approval must be included with the North Carolina income tax return filed by the nonresident member.

In determining the North Carolina source income of a nonresident member of a professional athletic team, the following definitions apply:

a. The term "professional athletic team" includes, but is not limited to, any professional baseball, basketball, football, soccer, or hockey team.

b. The term "member of a professional athletic team" includes those employees who are active players, players on the disabled list and any other persons required to travel and who do travel with and perform services on behalf of a professional athletic team on a regular basis. This includes, but is not limited to, coaches, managers and trainers.

c. The term "duty days" means all days during the taxable year from the beginning of the professional athletic team's official preseason training period through the last game in which the team competes or is scheduled to compete.

   Duty days also include days on which a member of a professional athletic team renders a service for a team on a date that does not fall within the aforementioned period. Such services include participation in instructional leagues, the "Pro Bowl," or promotional caravans. This includes days during the member's off-season where the member conducts training activities at the facilities of the team.

   Duty days include game days, practice days, days spent at team meetings, promotional caravans and preseason training camps, and days served with the team through all post-season games in which the team competes or is scheduled to compete.

   Duty days for any person who joins a team during the season begins on the day the person joins the team, and for any person who leaves a team ends on the day the person leaves the team. Where a person switches teams during the taxable year, a separate duty day calculation will be made for the period the person was with each team.

Days for which a member of a professional athletic team is not compensated and is not rendering services for the team in any manner, including days when the person has been suspended without pay and prohibited from performing any services for the team, are not treated as duty days.

Days for which a player is on the disabled list are presumed not to be duty days spent in North Carolina. However, the days are considered to be included in total duty days spent within and without North Carolina.

d. The term "total compensation for services rendered as a member of a professional athletic team" means the total compensation received during the taxable year for services rendered:

   1. From the beginning of the official preseason training period through the last game in which the team competes or is scheduled to compete during that taxable year; and

   2. For an event during the taxable year which occurs on a date that does not fall within the aforementioned period such as participation in instructional leagues, the "Pro Bowl" or promotional "caravans."

   The compensation includes, but is not limited to, salaries, wages, bonuses, and any other type of compensation identified in Code section 61 and its regulations and paid during the taxable year for services performed in that year. Such compensation does not include strike benefits, severance pay, termination pay, contract or option year buy-out payments, expansion or relocation payments, or any other payments not related to services rendered to the team.

e. "Bonuses" are included in "total compensation for services rendered as a member of a professional athletic team" and subject to allocation if they are:

   1. Earned because of play, such as performance bonuses, during the season, including bonuses paid for championship, playoff or "bowl" games played by a team, or for selection to all-star league or other honorary positions; and

   2. Paid for signing a contract, unless all the following conditions are met:

      a. The payment of the signing bonus is not conditional upon the signee playing any games for the team, or performing any subsequent services for the team, or even making the team.

      b. The signing bonus is payable separately from the salary and any other compensation.

c. The signing bonus in nonrefundable.

For more information on withholding requirements of professional athletic teams, see Professional Athletes.

Reference: 17 NCAC 06B .3905.

8. Severance Wages & Unemployment Compensation

a. Severance Wages

Severance wages may be granted by a taxpayer's employer because of the taxpayer's permanent, involuntary termination from employment. Because severance wages are paid to a taxpayer after a taxpayer's employment ends, they do not constitute compensation for services performed. Consequently, severance wages paid to a nonresident of North Carolina are not taxable by North Carolina even if paid in connection with a job in North Carolina. In addition, severance wages paid to a North Carolina resident are taxable by North Carolina even if paid in connection with a job outside of North Carolina.

Example 1. *Taxpayer is a North Carolina resident and employed at a North Carolina business. Taxpayer is laid off in October 2024. In November 2024 Taxpayer changes his domicile to Georgia. Taxpayer receives severance pay from his previous employer beginning February 2025.*

Taxpayer's severance pay is not subject to North Carolina tax because Taxpayer is no longer a resident of North Carolina when the payments are made.

Example 2. *Taxpayer is a Virginia resident and employed at a Virginia business. Taxpayer is laid off in June 2024. In July 2025 Taxpayer changes her domicile to North Carolina. Taxpayer receives severance pay from her previous employer beginning February 2025.*

Taxpayer's severance pay is subject to North Carolina tax because Taxpayer is a resident of North Carolina when the payments are made.

b. Unemployment Compensation

Unemployment insurance provides temporary assistance to individuals who have become unemployed due to no fault of their own. Unemployment compensation includes state unemployment insurance benefits and benefits paid by a state or the District of Columbia from the Federal Unemployment Trust Fund. It also includes railroad unemployment compensation benefits, but not worker's compensation. Generally, unemployment compensation is included in adjusted gross income. Unemployment compensation received by a North Carolina resident is taxable by North Carolina regardless of the state where the taxpayer's former employer paid unemployment taxes and regardless of the location of the taxpayer's previous place of employment.

Example. *Taxpayer is a North Carolina resident and was employed at a South Carolina business. Taxpayer is laid off in January 2025. During February and March 2025, Taxpayer receives unemployment compensation from the state of South Carolina while a North Carolina resident.*

Taxpayer's unemployment compensation is subject to North Carolina tax because Taxpayer is a resident of North Carolina when the payments are made.

9. Non-qualified Stock Option

a. General

Under federal law, a non-qualified (or "non-statutory") stock option is deemed to be property transferred in connection with the performance of a service and is treated as a supplemental wage. For federal income tax purposes, the non-qualified stock option is taxable in the year the option is granted if the option has an ascertainable fair market value at the time the option is granted. If the option does not have a readily ascertainable fair market value at the time the option is granted, the option is taxable in the year the option is exercised.

b. Non-qualified Stock Options Without a Readily Ascertainable Fair Market Value

For North Carolina income tax purposes, a resident of North Carolina must include in the computation of North Carolina taxable income the recognized gain or loss from the non-qualified stock option in the year the option is exercised. A resident taxpayer may be entitled to a tax credit for taxes paid to another state on the income from the non-qualified stock option under G.S. § 105-153.9.

Pursuant to G.S. § 105-153.4(b), the taxable income of a nonresident of North Carolina includes any income that was derived from a business, trade, profession, or occupation carried on in North Carolina. A non-qualified stock option earned by a taxpayer while working in North Carolina is subject to North Carolina income tax even if the option is exercised when the taxpayer is a resident of another state.

If a taxpayer is a nonresident of North Carolina at the time the non-qualified stock option is exercised, and the option is attributable to services performed in North Carolina and another state (or states), North Carolina will tax only the income attributable to services performed in North Carolina. To calculate the amount of income attributable to North Carolina, the nonresident taxpayer must divide the number of days worked in North Carolina during the period between the grant date and exercise date of the non-qualified stock option by the number of days worked everywhere between the grant date and exercise date of the non-qualified stock option. Multiply the resulting fraction by the amount of income recognized to determine the amount of income to include on Form D-400 Schedule PN, Part-Year Resident and Nonresident Schedule.

V. Bailey Settlement

As a result of the North Carolina Supreme Court's decision in *Bailey v. State of North Carolina* and the settlement subsequently reached in that case, North Carolina may not tax retirement benefits received by a retiree (or by a beneficiary of a retiree) from qualifying State, local, or federal retirement systems if the retiree was vested in the retirement system as of August 12, 1989. For most government retirement systems, a person is vested if the person had five or more years of creditable service in a qualifying State, local or federal retirement system as of August 12, 1989. For certain retirement systems, the vesting period is less.

1. Qualifying State or Local Retirement System

The following retirement systems were designated as a North Carolina State or local governmental retirement system:

System	**Law Creating the System**
North Carolina Teachers' and State Employees' Retirement System (TSERS)	G.S. § 135, Article 1
Optional Retirement Program available to administrators and faculty of the University of North Carolina system in lieu of TSERS	G.S. § 135-5.1
North Carolina Local Governmental Employees' Retirement System	G.S. § 128, Article 3
North Carolina Consolidated Judicial Retirement System	G.S. § 135, Article 4
North Carolina Legislative Retirement System	G.S. § 120, Article 1A
North Carolina Disability Income Plan (both short-term and long-term disability benefits)	G.S. § 135, Article 6
North Carolina Supplemental Retirement Income Plan	G.S. § 135, Article 5
North Carolina Supplemental Retirement Income Plan for State Law Enforcement Officers	G.S. § 143-166.30(d)
North Carolina Deferred Compensation Plan	G.S. § 143B-426.24
North Carolina National Guard Pension Fund	G.S. § 127A-40
North Carolina Sheriffs' Supplemental Pension Fund	G.S. § 143, Article 12H
North Carolina Registers of Deeds' Supplemental Pension Fund	G.S. § 161, Article 3
North Carolina Supplemental Retirement Plan for Local Governmental Law Enforcement Officers	G.S. § 143-166.50(e)

Separate Insurance Benefits Plan for State and Local Governmental Law Enforcement Officers	G.S. § 143-166.60
North Carolina Firemen's and Rescue Squad Workers' Pension Fund	G.S. § 58, Article 86
Charlotte Firefighters' Retirement System	Session Laws 1947, Chapter 926, § 6(c)
Firemen's Supplemental Fund of Hickory	Session Laws 1971, Chapter 65
Winston-Salem Police Officers' Retirement System	Session Laws 1939, Chapter 296
New Hanover County School Employees' 1979 Retirement Plan	Session Laws 1979, Chapter 1307

No local government optional contribution plans, similar to the State's Supplemental Retirement Income Plan and Deferred Compensation Plan, were afforded tax exemption prior to August 12, 1989. Therefore, retirement benefits from local government optional contribution plans (such as local government 457 plans) are not subject to future tax exemption.

Teachers and other employees of North Carolina's public schools have the option of contributing to optional contribution plans established pursuant to section 403(b) of the Code. Distributions from these plans may not be excluded from taxable income under the settlement.

The "special separation allowance" paid to retired law enforcement officers pursuant to G.S. § 143-166.41 and reported on federal Form W-2 does not qualify for exclusion under *Bailey*.

2. Vesting Period for Qualifying State or Local Retirement Systems

The general rule is that a participant in a qualifying State or local retirement system is vested if the participant had five or more years of creditable service as of August 12, 1989. However, the general rule does not apply to qualifying optional contribution plans or to certain other qualifying plans.

Participants in the State's Supplemental Retirement Income Plan (Code § 401(k)) or the State's Deferred Compensation Plan (Code § 457) are vested in the plan as of August 12, 1989, if they contributed or contracted to contribute to the plan by August 12, 1989. If the participant contributed any money to a plan before August 12, 1989, all future withdrawals from that plan are excludable from tax. Contributions to one plan prior to August 12, 1989, do not qualify contributions to the other plan as vested. For example, if a State employee began contributing to the § 401(k) plan in June 1989, and to the § 457 plan in October 1989, the employee is vested only in the § 401(k) plan. Participants in the State's Supplemental Retirement Income Plan or the State's Deferred Compensation Plan may have chosen an annuity as an investment option. In some cases, they receive the annuity payments and the subsequent tax information statement from the annuity company instead of the plan administrator. These amounts also qualify for future tax exemption if the retiree was vested.

Participants in the North Carolina Firemen's and Rescue Squad Workers' Pension Fund are vested as of August 12, 1989, only if the individual had both five years of service and had paid five years of contributions to the plan by August 12, 1989. Sheriffs receiving benefits from the North Carolina Sheriffs' Supplemental Pension Fund and Registers of Deeds receiving benefits from the North Carolina Registers of Deeds' Supplemental Pension Fund are vested as of August 12, 1989, only if the sheriff or the register of deeds (not a deputy or assistant) had five years of service as a sheriff or a register of deeds and five years of participation in the Local Governmental Employees' Retirement System (or equivalent local plan) by August 12, 1989.

An employee in a qualifying State or local governmental retirement system who was vested prior to August 12, 1989, and who leaves employment remains vested if the employee later returns to work, provided the employee did not withdraw the employee's contributions to the retirement system. If the employee withdrew the contributions, the employee is no longer vested in the retirement system, even if the employee subsequently buys back the service time, unless the employee returned to employment in time to become vested again before August 12, 1989.

3. Qualifying Federal Retirement Systems

The following retirement systems were designated as a federal governmental retirement system:

- Federal Civil Service Retirement System
- Federal Employees' Retirement System
- Lighthouse Retirement System
- Thrift Savings Plan
- Foreign Service Retirement and Disability System and Pension System
- Military Retirement System
- Coast Guard Retirement System
- Central Intelligence Agency Retirement System
- Commissioned Corps of the Public Health Service Retirement System
- Comptrollers' General Retirement Plan
- Judicial Plans & Pay for Federal Judges Treated as Retirement Pay by Federal Law, including:
    - Judicial Retirement System
    - Judicial Survivors' Annuities System
    - Court of Federal Claims Judges' Retirement System
    - Court of Veterans Appeals Judges' Retirement Plan
    - Judicial Officers' Retirement System (for Bankruptcy Judges and Magistrates)
    - United States Tax Court Retirement Plan
    - United States Tax Court Survivors' Annuity Plan
    - Retirement Plans for District Court Judges for the Northern Mariana Islands, the Virgin Islands, and Guam
    - Court of Appeals for the Armed Forces Judges Retirement System

- National Oceanic and Atmospheric Administration Retirement System
- Tennessee Valley Authority Retirement System and TVA Savings and Deferral Retirement Plan
- Financial Institutions Retirement Fund (Office of Thrift Supervision Employees)
- Federal Home Loan Bank Board Retirement Systems
- Federal Home Loan Mortgage Corporation Plan
- Federal Reserve Employees Retirement Plans and Thrift Plan
- Nonappropriated fund plans, including:
  - Retirement Annuity Plan for Employees of Army and Air Force Exchange Service
  - Supplemental Deferred Compensation Plan for Members of the Executive Management Program (Army and Air Force Exchange Service)
  - Nonappropriated Fund Retirement Plan for Civilian Employees
  - United States Army Nonappropriated Fund Retirement Plan
  - Retirement Plan for Civilian Employees of United States Marine Corps Morale, Welfare, and Recreation Activities and Miscellaneous Nonappropriated Fund Instrumentalities
  - Navy Exchange Service Command Retirement Plan
  - Navy Nonappropriated Fund Retirement Plan for Employees of Civilian Morale, Welfare, and Recreation Activities
  - Norfolk Naval Shipyard Pension Plan
  - Retirement Savings Plan and Trust for Employees of the Army and Air Force Exchange Service
  - Coast Guard Nonappropriated Fund Retirement Plan
- District of Columbia Police Officers and Fire Fighters' Retirement Fund and Related Funds (including payments to Secret Service and U.S. Park Police covered by the Fund)
- District of Columbia Teachers' Retirement Fund and Related Funds
- District of Columbia Judges' Retirement Fund and Related Funds
- Uniformed Services University of the Health Sciences Plan
- Smithsonian Institution Defined Contribution Retirement Plan
- USDA Graduate School Plan

4. Vesting Period for Qualifying Federal Retirement Systems

Generally, participants in the qualifying federal retirement systems listed above, including military retirees, are vested for purposes of the settlement if they had five or more years of creditable service as of August 12, 1989. The general rule, however, does not apply to the Thrift Savings Plan.

The Thrift Savings Plan has both an employee and an employer component. The employee component is similar to the State's § 401(k) and § 457 plans and allows the employee to voluntarily contribute to the Plan. The employee is vested in the employee component if the employee first made a contribution to the plan prior to August 12, 1989. The employer component includes both contributions by the employer of a fixed percentage of the employee's salary and contributions by the employer that match the employee's voluntary contributions. The employee is also vested in the employer matching contributions if the employer first made a matching contribution prior to August 12, 1989. An employee is vested in the employer fixed component only if the employee had three years of service (two years of service for certain highly ranked employees) as of August 12, 1989. One exception to the three-year rule is that an employee who died prior to completing the mandatory three years is still considered vested if the date of death was on or before August 12, 1989.

As explained above, it is possible for a participant in the Federal Thrift Savings Plan to be vested as of August 12, 1989, in some components of the plan while at the same time not being vested in other components. The annual tax information statement (federal Form 1099-R) does not distinguish between the various components when reporting the amount distributed during the year; therefore, the recipient cannot readily determine the amount to exclude from North Carolina income tax. When a participant in the plan ceases employment, the recipient should request a statement that identifies the cash balances in the various components. To determine the proper amount to exclude, the recipient should multiply the annual distribution by a fraction, the numerator of which is the balance of the components in which the recipient is vested as of August 12, 1989. The denominator of the fraction is the total cash balance of all components. That same fraction will be used for each year the recipient receives distributions from the plan.

5. Rollover Distributions with Respect to Bailey Retirement Plans – General

The Economic Growth and Tax Relief Reconciliation Act of 2001 made numerous changes with respect to pension portability. All distributions from a qualifying *Bailey* retirement account in which the employee/retiree was "vested" as of August 12, 1989, are exempt from State income tax regardless of the source of the funds contained in the account. Conversely, qualifying tax-exempt *Bailey* benefits rolled over into another retirement plan lose their character and would not be exempt upon distribution from the other plan unless that plan is a qualifying *Bailey* retirement account in which the employee was vested as of August 12, 1989.

For more information, see Departmental Directive PD-04-1. For special rules regarding the Optional Retirement Program, see Departmental Directive PD-00-1.

6. Bailey Retirement Plan Rollover Distribution to a Roth Account

Effective January 1, 2008, distributions from qualified retirement plans could be rolled over into Roth IRAs. Qualified retirement plans include §§ 401(k), 403(b), and 457 plans. A rollover distribution to a Roth account is generally taxable at the time of the rollover and the subsequent distributions from the Roth account are generally not taxable. If the rollover to a Roth account is from a qualifying tax-exempt *Bailey* retirement account, the rollover distribution is exempt from State income tax and deductible on the State return to the extent the rollover distribution was included as income on the taxpayer's federal income tax return.

For more information, see Departmental Directive PD-14-1.

7. Transfers between Supplemental Retirement Plans and North Carolina State or Local Retirement Systems

Session Laws 2007-384 and 2010-124, enacted legislation that provided for a Special Retirement Allowance for Law Enforcement Officers and other North Carolina state and local government employees. This Special Retirement Allowance provided these employees or retirees the option to transfer accumulated contributions from their Supplemental Retirement Income Plan or Deferred Compensation Plan to the Teachers' and State Employees' Retirement System (TSERS) and/or the Local Governmental Employees' Retirement System (LGERS). The law specifically states that these transfers do not cause the contributions to lose their status as being either qualifying tax-exempt *Bailey* benefits or non-qualifying benefits. The Teachers' and State Employees' Retirement System is responsible for determining the taxable amount, if any, and will report this information to the retiree.

8. Termination or Death Prior to Retirement

As noted in the Department's Directive PD-99-2, an individual who was vested in a qualifying retirement system as of August 12, 1989, and who receives a distribution from the system because of termination of employment prior to retirement may exclude the distributions from North Carolina taxable income. Similarly, an individual who receives a distribution from the system as a beneficiary of an individual who was vested in the system and who died while employed may exclude the distributions from North Carolina taxable income.

9. Interaction with Uniformed Services Retiree Deduction

G.S. § 105-153.5(b) provides an individual with a North Carolina income tax deduction for retirement pay for service in the Uniformed Services of the United States. The deduction is available for retired members that served at least 20 years or medically retired under 10 U.S.C. Chapter 61. The deduction is also available for a beneficiary of an eligible retired member for payments made to the beneficiary from a Plan defined in 10 U.S.C. § 1447. Taxpayers who qualify for and make the *Bailey* deduction under G.S. § 105-153.5(b)(5) may not deduct the same income under the provisions of G.S. § 105-153.5(b)(5a).

VI. Partnerships

1. Preliminary Statement on Taxed Partnerships

G.S. § 105-154.1 allows eligible partnerships to elect to pay North Carolina income taxes at the entity level (a "Taxed Partnership"). For information regarding Taxed Partnerships, see Taxed Pass-Through Entities.

Important: For purposes of Section VI, unless specifically stated otherwise, a "partnership" is **NOT** a "Taxed Partnership."

2. General

The starting point for preparing the North Carolina partnership income tax return, Form D-403, is the partnership's total income or loss. If the partnership provides a copy of its federal partnership income tax return (Form 1065) with its North Carolina partnership return, the partnership can enter the sum of lines 1 through 11 of Schedule K, Form 1065[1] as total income or loss on Form D-403, Part 1, line 1 in lieu of completing Form D-403, Part 6. The additions and deductions required for individuals under G. S. § 105-153.5 and G.S. § 105-153.6 apply to partnerships.

Important: Only the adjustments allowed by North Carolina law can be claimed on the partnership return. Deductions reported on Federal Form 1065, Schedule K, Lines 12 and 13 cannot be claimed on the North Carolina partnership return.

The partnership income tax return shall include the names and addresses of the persons entitled to share in the net income of the partnership and shall be signed by the managing partner and the individual preparing the return. Income from an intangible source which is received in the course of doing business in the State so as to have a taxable situs here (including such income which is included in the distributive share of partnership income, whether distributed or not) is included in the numerator of the fraction used in determining the portion of income that is taxable to North Carolina by a nonresident.

Reference: G.S. § 105-154; 17 NCAC 06B .3501.

3. Time and Place for Filing a Partnership Return

A North Carolina partnership income tax return, Form D-403, must be filed by every partnership doing business in North Carolina if a federal partnership return was required to be filed. The return of a partnership on a calendar year basis is due on or before April 15 following the close of the calendar year. If on a fiscal year basis, the return must be filed on or before the 15th day of the fourth month following the close of the fiscal year. For information on

[1] The lines must reflect the amounts calculated under the Code.

when a document is considered timely filed, see Departmental Directive TA-16-1 and Departmental Directive TA-18-1.

If the partnership return cannot be filed by the due date, the partnership may apply for an automatic six-month extension of time to file the return. A partnership 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 income tax return. To receive an automatic State extension, the partnership must certify on the North Carolina tax return that the partnership was granted an automatic federal extension. If the partnership is not granted an automatic federal extension, the partnership must file Form D-410P, Application for Extension for Filing Partnership, Estate, or Trust Tax Return, by the original due date of the return in order to receive an extension for North Carolina purposes.

Reference: G.S. § 105-155; 17 NCAC 06B .3503.

4. Refund Requests for Tax Paid on Behalf of a Nonresident Partner

The manager of a partnership may not request a refund of an overpayment made on behalf of a nonresident owner or partner if the manager of the business has already filed the partnership return and paid the tax due. The nonresident owner or partner may, on its own income tax return, request a refund of an overpayment made on its behalf by the manager of the partnership within the provisions of G.S. § 105-241.6. A nonresident individual partner who is not required to file a North Carolina individual income tax return pursuant to the provisions 17 NCAC 06B .3513 must file a North Carolina individual income tax return in order to receive a refund of tax paid on the nonresident partner's behalf by the manager of the partnership.

Reference: G.S. § 105-154; G.S. § 105-154.1.

5. Electronic Filing

A partnership may file a tax return with the Department of Revenue electronically only when the Department has established and implemented procedures permitting electronic filing of a specific tax return. A return may be filed electronically only by using the procedures established by the Department for the particular return.

Electronic tax filing (eFile) is an electronic method of filing and paying income taxes using third party tax preparation software approved by NCDOR. Visit eFile Resources for Taxpayers for information about the Department's authorized eFile programs.

When filing electronically, tax practitioners and taxpayers must eFile using IRS and Department approved, commercially developed, software products. Visit Approved eFile Software Products to access a list of approved software products. To participate in the Federal/State eFile program, a tax practitioner should refer to Federal Publication 3112, Applying and Participating in IRS E-file.

6. Form NC-PE, Form NC K-1, and Form NC K-1 Supplemental Schedule

a. Form NC-PE

Every partnership required to add certain North Carolina adjustments to the partnership's total income (or loss), or allowed to deduct certain North Carolina adjustments from the partnership's total income (or loss), must complete Form NC-PE and attach it to Form D-403.

Certain adjustments must be made to the partnership's income (loss) when calculating North Carolina taxable income. Specifically, a partnership's income (loss) is subject to the additions and deductions that are required and permitted, respectively, of individuals who must file a North Carolina individual income tax return. However, some adjustments do not apply to partnerships.

Form NC-PE lists all the adjustments permitted by statute for an individual. To determine if a North Carolina adjustment applies to a partnership, the partnership must review applicable federal and State tax law.

Note: A deduction reported on Federal Form 1065, Schedule K, Lines 12 and 13 cannot be claimed on the Form NC-PE. If a particular item is not listed on Form NC-PE and the partnership believes the item should be an addition to (or a deduction from) the partnership's total income (or loss), the partnership should contact the Department before making the adjustment.

b. Form D-403 NC K-1

Form D-403 NC K-1 is used by the partnership to report each partner's distributive share of the partnership's income, adjustments, tax credits, tax paid, etc. Form NC K-1 must reflect the net North Carolina tax paid by the partnership on behalf of the partner. A partner's distributive share of partnership income includes any guaranteed payments made to the partner. The partnership must provide a completed Form NC K-1, or other documents containing all of the information that would be reported on Form NC K-1, to each person who was a partner in the partnership at any time during the year. This form must be provided to each partner on or before the day on which the partnership return is required to be filed. When reporting the distributive share of tax credits, a list of the amount and type of tax credits should be provided to each partner.

c. Form NC-K-1 Supplemental Schedule

The NC K-1 Supplemental Schedule is used by the partnership to report to each partner the partner's share of North Carolina adjustments reported by the partnership on Form NC-PE.

Reference: G.S. § 105-154; 17 NCAC 06B .3503.

7. Informational Return Penalty

Pursuant to G.S. § 105-236(a)(10), the penalty for failure to file an informational return by the due date is $50 per day, up to a maximum of $1,000. This penalty applies to any partnership return filed after the due date, regardless of whether the return indicated a tax due, an overpayment, or no tax due. For a partnership return on which an income tax is due, the failure to file penalty, the failure to pay penalty, and the informational return penalty may be assessed when applicable. For more information, see Penalties and Interest.

8. Nonresident Partner

a. Requirement to Pay Tax on Behalf of a Nonresident Partner

When an established business in North Carolina is owned by a partnership having one or more nonresident partners, the business is responsible for reporting the share of the income of each nonresident partner and is required to compute and pay the tax due on behalf of those partners. The tax rate is the same as the tax rate for individuals. The Department may enforce the partnership's liability for the tax on each nonresident partner's share of the income by sending the partnership a notice of proposed assessment in accordance with G.S. § 105-241.9.

If the nonresident partner is a corporation, partnership, trust or estate, the partnership is not required to pay the tax on that partner's share of the partnership income if the partner provides Form D-403 NC-NPA, Nonresident Partner Affirmation. Form D-403 NC-NPA affirms that the partner will pay the tax with its corporation, partnership, trust, or estate income tax return. The affirmation must be filed annually by the nonresident partner and submitted by the manager by the due date of the partnership return. The affirmation must be signed by the partner. An unsigned form is not considered valid. The signed affirmation applies to the original return, any amended returns for that year, and any proposed assessments of additional tax for that year.

In addition, if a nonresident partner is not an individual and the partner has executed an affirmation that the partner is not subject to North Carolina income tax, the partnership is not required to pay the tax on behalf of the nonresident partner. Otherwise, the partnership is required to pay the tax on the nonresident partner's share.

Payment of the tax due by the partnership on behalf of corporations, partnerships, trusts and estates that are partners does not relieve the partner from filing a North Carolina income tax return; however, credit for the tax paid by the partnership may be claimed by the partner on the partner's North Carolina individual income tax return.

Publicly Traded Partnership. A publicly traded partnership as described in section 7704 of the Code is required to file an information return only for nonresident partners whose distributive share of the partnership net income for the tax year is more than $500. The return should list the partner's name, address, taxpayer identification number, and the partner's share of income from the partnership for the tax year. A publicly traded partnership is not required to pay the tax on behalf of the nonresident partners.

Taxed Partnership. A Taxed Partnership with partners described in G.S. § 105-154.1(a)(5) is subject to the provisions of G.S. § 105-154(d) with respect to those partners. For more information, see Taxed Pass-Through Entities.

b. Other Income of a Nonresident Partner

Although a partnership may treat guaranteed payments to a partner for services or for use of capital as if they were paid to a person who is not a partner, that treatment is only for purposes of determining the partnership's gross income and deductible business expenses. For other tax purposes, guaranteed payments are treated as a partner's distributive share of ordinary income. In determining the allowable North Carolina deductions from income, do not include a partner's salary, interest on a partner's capital account, partner relocation and mortgage interest differential payments. These types of payments are treated as part of the partner's share of the partnership income.

For more information regarding the calculation of tax due for nonresident partners, see Departmental Directive PD-14-02.

c. Commercial Domicile

For the purposes of G.S. § 105-154(d), a corporation or LLC is a nonresident of North Carolina if its commercial domicile is not in North Carolina and North Carolina is not its state of incorporation or organization. Commercial domicile means the principal place from which the trade or business of the partner is directed or managed. In addition, a partnership is presumed to be a nonresident of North Carolina if the partner's address of record is outside of North Carolina. This presumption may be overcome by evidence of the relevant facts and circumstances showing that the partner is domiciled in North Carolina. For the purposes of G.S. § 105-154(d), an individual is considered a nonresident partner if they are a nonresident of North Carolina on the last day of the tax year.

d. Nonresident Individual Partner Filing Requirements

A nonresident individual partner is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the nonresident's share of income from a partnership doing business in North Carolina and the manager of the partnership has reported the income of the nonresident partner, including any guaranteed payments made to the partner, and has paid the tax due for the nonresident individual partner. However, for a nonresident individual partner to deduct a North Carolina net operating loss in a future tax year, the nonresident individual partner must file a North Carolina individual income tax return in the year of the loss, even if the partner's only income from North Carolina sources is the partner's share of income from a partnership doing business in North Carolina. See Net Operating Losses for more information.

A nonresident individual partner may file an individual income tax return and claim credit for the tax paid by the manager of the partnership if the partner submits with the individual income tax return the Form D-403 NC K-1 or other document from the partnership verifying that the partnership paid tax on behalf of the partner.

Note: Certain North Carolina adjustments provided under G.S. §§ 105-153.5 and 105-153.6 have both an addition and deduction component whereby a nonresident individual partner must include the addition in North Carolina taxable income and pay any tax due to qualify for the corresponding deduction in a subsequent tax year.

Example. *Partner A is a nonresident partner of Partnership X, a partnership doing business in North Carolina. Partnership A placed section 179 property in service during 2024 and claimed the corresponding federal section 179 expense, a portion of which was allocated to Partner A. Partner A's only income from North Carolina sources is Partner A's share of income from a Partnership X. The manager of Partnership X reported the income of Partner A and paid the tax due for Partner A on the partnership's annual income tax return for 2024. Partner A does not file a North Carolina individual income tax return for 2024. Partner A files a North Carolina individual income tax return for 2025 claiming a deduction for section 179 expense added back in 2024.*

Section 179 expense is a separately stated item of deduction and is not included when calculating Partner A's share of partnership income. Consequently, the addition for section 179 expense required under G.S. § 105-153.6(c) is also not included in the calculation of Partner A's share of partnership income for which the partnership is required to pay tax on Partner A's behalf. Because Partner A did not include the required addition for section 179 expense in 2024 North Carolina taxable income, Partner A is not eligible for the corresponding deduction claimed in 2025.

Reference: G.S. § 105-154; 17 NCAC 06B .3513.

9. Disposition of a Partner's Interest

An interest in a partnership is intangible personal property. A nonresident partner does not include the gain from the sale of an interest in a partnership in the numerator of the fraction in determining North Carolina taxable income unless the sale of the partnership interest conveys title to specific partnership property. If a partnership owning an interest in another partnership sells its interest in that partnership, the nonresident partner does not include their distributive shares of the gain realized by the partnership from the sale of its partnership interest in the numerator unless the partnership selling its interest is carrying on a trade or business in this State.

A nonresident partner must include their distributive shares of the gains or losses from the sale or other disposition of the partnership's assets in the numerator of the fraction in determining North Carolina taxable income. If the sale of a partnership interest conveys title to specific partnership property instead of to a limited interest in the partnership, the transaction will be considered as a sale of partnership assets for purposes of determining North Carolina taxable income.

Reference: 17 NCAC 06B .3527.

10. Part-Year Resident

A part-year resident with distributive income from a partnership doing business in North Carolina and in one or more other states must prorate their shares of the partnership's income attributable and not attributable to North Carolina between the periods of residence and non-residence in accordance with the number of days in each period. The amount required to be included in the numerator of the fraction for determining taxable income is the taxpayer's share of partnership income determined for the period of residence plus the taxpayer's share of the partnership income attributable to North Carolina during the period of non-residence.

Reference: G.S. § 105-153.4; 17 NCAC 06B .3528.

11. Estimated Income Tax

A partnership is not required to pay estimated income tax. A partner who is a resident of North Carolina and who meets the statutory requirements to pay estimated income tax must pay the estimated income tax on Form NC-40, Individual Estimated Income Tax. Nonresident individual partners are not required to pay estimated tax on their distributive share of partnership income.

Note: A Taxed Partnership is generally required to make estimated income tax payments if the Taxed Partnership expects to have a N.C. income tax liability of $500 or more.

Reference: 17 NCAC 06B .3521.

12. Allocating Bonus Depreciation to a Partner

The deduction for bonus depreciation allowed under G.S. § 105-153.6(a) can only be allocated to a partner who was allocated the corresponding addition for bonus depreciation in an earlier tax year. The amount of the allocated deduction for bonus depreciation in the current year is 20 percent of the amount of the addition allocated to the partner in the earlier tax year. A partner who is allocated bonus depreciation from the partnership is not entitled to the deduction for bonus depreciation on the partner's North Carolina individual income tax return if the partner did not make the corresponding addition for bonus depreciation on the partner's N.C. individual income tax return.

Reference: G.S. § 105-153.5; G.S. § 105-153.6.

13. Interest Income Passed Through to a Partner

Although the interest income passed through to a partner in a partnership retains its same character as when received by the partnership, the expenses incurred in earning interest income are either deductible by the partnership and net interest income after expenses is reflected in the partner's pro rata share of the income of the partnership or not deductible by the partnership and interest income before expenses is reflected in the partner's pro rata share of the income of the partnership.

Net interest income shall be reported if the activities are considered trade or business activities under federal law and interest income before expenses shall be reported if the activities are considered investment activities under federal law. If the activities are considered investment activities, the expenses incurred in earning that income shall be reported by the partnership to its partners as a separately stated item and shall be deducted by the partner to the extent allowable on the partner's income tax return.

For interest income subject to federal income tax and considered trade or business activities, the partner's federal gross income includes the net interest income after expenses incurred in earning the income. If that interest income is deductible from federal adjusted gross income pursuant to G.S. § 105-153.5(b), the individual partner shall deduct the net income on the North Carolina return. For interest income subject to federal income tax and considered investment activities, the partner's federal gross income includes the interest income before expenses incurred in earning the income. If that interest income is deductible from federal adjusted gross income pursuant to G.S. § 105-153.5(b), the individual partner shall deduct the income before expenses on the North Carolina return. No addition shall be made for the expenses incurred in earning that income to the extent those expenses are deductible by the individual partner in arriving at federal adjusted gross income.

Interest income not subject to federal income tax is not included in the partner's federal adjusted gross income. For interest income not subject to federal tax but required to be added to federal adjusted gross income pursuant to G.S. § 105-153.5(c), the individual partner shall add the total interest income on the North Carolina return. No deduction shall be made for expenses incurred in earning that income if the expenses are not deductible in arriving at federal adjusted gross income. In these cases, a partner must adjust federal adjusted gross income as required by G.S. § 105-153.5 (b) or G.S. § 105-153.5(c), for the net amount of interest attributable to the partnership.

Reference: 17 NCAC 06B .3529.

14. Income Tax Credits of a Partnership

A partnership may pass through to each of its partners the partner's distributive share of an income tax credit for which the partnership qualifies. Any dollar limit on the amount of a tax credit applies to the partnership as a whole instead of to the individual partners. The maximum dollar limits and other limitations that apply in determining the amount of tax credit available to a taxpayer apply to the same extent in determining the amount of tax credit for which the partnership qualifies, except the limitation that the tax credit cannot exceed the tax liability of the taxpayer.

Reference: G.S. § 105-269.15.

15. Limited Liability Company

The North Carolina Limited Liability Company Act (Chapter 57D) of the North Carolina General Statutes permits the organization and operation of limited liability companies. A limited liability company ("LLC") is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership. An LLC is subject to State taxation according to its classification for federal income tax purposes. Therefore, if an LLC is classified as a partnership for federal income tax purposes, the LLC and its members are subject to State tax to the same extent as a partnership and its partners are required to file a North Carolina partnership return.

An LLC may be organized by a single member by delivering executed articles of organization to the Secretary of State.

16. Foreign Partnership

North Carolina income tax is required to be withheld from compensation paid to a foreign partnership for certain personal services performed in North Carolina. For more information, see Withholding from Nonwage Compensation. If the partnership has a permanent place of business in North Carolina, no tax is required to be withheld if the partnership provides to the payer the partnership's address and taxpayer identification number.

A partnership may claim credit on the partnership income tax return, Form D-403, for the portion of the tax withheld attributable to a nonresident partner on whose behalf the partnership pays tax. The portion of the tax withheld attributable to a resident partner or a nonresident partner that has provided an affirmation to the partnership (see Nonresident Partners) must be allocated to those partners on Form NC K-1.

17. Investment Partnership

A partnership whose only activity is as an investment partnership is not considered to be doing business in North Carolina. An investment partnership is a partnership that is not a dealer in securities, as defined in section 475(c)(1) of the Code, and that derives income exclusively from buying, holding, and selling securities for its own account. If any of the partnership's income consists of ordinary operating income whether from direct activities or flowing through from other partnerships, the partnership is not considered an investment partnership for North Carolina tax purposes.

Note: For North Carolina purposes, a partnership's status as an investment partnership for a particular tax year is determined based on the partnership's activity for that tax year.

An investment partnership is not required to file an income tax return in North Carolina or pay income tax to North Carolina on behalf of its nonresident partners.

Reference: 17 NCAC 06B .3503.

VII. S Corporations

1. Preliminary Statement on Taxed S Corporations

G.S. § 105-131.1A allows an S Corporation to elect to pay North Carolina income tax at the entity level a ("Taxed S Corporation"). For information about Taxed S Corporations, see Taxed Pass-Through Entities.

Important: For purposes of Section VII, unless specifically stated otherwise, an "S Corporation" is **NOT** a "Taxed S Corporation."

2. General

An individual shareholder of an S corporation is required to take into account their pro rata share of an S corporation's net income in the manner provided under section 1366 of the Code subject to certain adjustments.

Reference: G.S. § 105-131; G.S. § 105-131.1.

3. Resident Shareholder

Since 100% of the S corporation's income is included in a resident shareholder's federal adjusted gross income starting point, no adjustment because of doing business outside of North Carolina is required by a resident.

4. Nonresident Shareholder

A nonresident shareholder of an S corporation takes into account only their share of the S corporation's income attributable to North Carolina in the numerator of the fraction in determining that portion of adjusted gross income that is taxable to North Carolina. If an S corporation does business in North Carolina and one or more other states, the income attributable to North Carolina is determined by the same apportionment formula as used for other corporations.

All nonresident shareholders must include an agreement with the first S corporation return filed with North Carolina agreeing to be liable and subject to the laws of North Carolina for individual income tax purposes; otherwise, the S corporation becomes liable for the tax on the income attributable to such nonresident shareholders at the rate for individuals.

A nonresident shareholder in an S corporation may claim credit on the shareholder's North Carolina individual income tax return for the tax paid on their behalf by the S corporation to North Carolina on the shareholder's share of the S corporation income.

Reference: G.S. §105-131.5; G.S. § 105-131.7; G.S. § 105-153.4; 17 NCAC 06B .4003.

5. Tax Credits

If part of the S corporation's income is earned within and taxed by another state or country, either to the individual or to the corporation, a resident shareholder is entitled to a tax credit on the individual income tax return for the amount of the tax paid to the other state or country. G.S. § 105-131.8 allows a tax credit for an S corporation's shareholders for taxes paid by the S corporation on the shareholders' "pro rata share of any net income tax paid by the S Corporation to a state that does not measure the income of S Corporation shareholders by the income of the S Corporation." If a state measures the income of the shareholders by the income of the S Corporation, even if the state taxes the S Corporation as a result of a SALT workaround in that state, the individual shareholders will not qualify for a tax credit for amounts paid to the other state by the S Corporation.

A shareholder claiming the tax credit must attach a schedule to the income tax return reflecting the total amount of tax paid to the other state or country by the S corporation and explaining how the shareholder's pro rata tax was determined. A separate tax credit must be calculated for each state or country to which the S corporation paid tax. Nonresident shareholders are not allowed credit for tax paid to another state or country.

A shareholder is subject to the individual adjustments under G.S. § 105-153.5 and G.S. § 105-153.6 rather than being subject to both individual and corporate income tax adjustments, regardless of the shareholder's residency status or whether the income is attributable to North Carolina.

Reference: G.S. § 105-131.8; 17 NCAC 06B .4004.

6. Basis in Stock

Due to different tax treatment of an S corporation's income for State and federal purposes for taxable years beginning before January 1, 1989, a shareholder's basis in the stock of an S corporation for State tax purposes may be different than for federal tax purposes; thereby requiring adjustments in determining North Carolina taxable income upon receipt by the shareholder of distributions from the S corporation and upon disposition of the S corporation stock.

The initial basis of the stock in an S corporation to a nonresident of North Carolina is zero, and the nonresident shareholder is not taxed on distributions from the corporation and recognizes no income or loss upon disposition of the stock. A nonresident shareholder's basis in the S corporation stock is adjusted for the shareholder's pro rata share of the income or loss of the corporation.

A resident shareholder's initial basis in the stock of an S corporation is determined as of the later of the date the stock is acquired, the effective date of the S corporation election, or the date the shareholder became a resident of North Carolina. A resident shareholder's basis in the stock is increased by the shareholder's pro rata share of the corporation's income, subject to the adjustments required under G.S. § 105-153.5 and G.S. § 105-153.6, except for income exempt from federal or State income taxes and deductions for depletion in excess of the basis of the property being depleted. The basis is decreased by distributions to the extent deemed a return of basis; a pro rata share of the losses of the corporation as adjusted under G.S. § 105-153.5 and G.S. § 105-153.6; nondeductible expenses of the corporation; and the amount of the shareholder's deduction for depletion of oil and gas wells to the extent the deduction does not exceed the proportionate share of the adjusted basis of that property allocated to the shareholder. The adjustments to the basis do not apply to tax periods beginning prior to January 1, 1989.

The aggregate amount of losses taken into account by the shareholder of an S corporation may not exceed the combined adjusted basis of the shareholder's stock and indebtedness of the corporation to the shareholder.

Example. *A is a resident of North Carolina and his share of the loss of an S corporation for the tax year 1989 is $50,000. On January 1, 1989, A's basis in the S corporation stock for federal income tax purposes was $110,000, comprised of $40,000 initial cost plus his share of the undistributed income of the S corporation of $70,000.*

Since for federal tax purposes the loss does not exceed his basis, the $50,000 is allowed as a deduction in computing federal taxable income. For State tax purposes, his basis is the $40,000 initial cost since the prior year undistributed income is not included in his basis due to being for tax years prior to January 1, 1989. Therefore, the loss that A may take into account in determining his North Carolina taxable income is $40,000 and he is required to adjust federal taxable income by $10,000 ($50,000 total loss less $40,000 basis).

Reference: G.S. § 105-131.3; 17 NCAC 06B .4005.

7. Distributions

A resident shareholder must take into account distributions from an S corporation in computing North Carolina taxable income to the extent the distributions are characterized as dividends or as gains pursuant to section 1368 of the Code. Section 1368 of the Code provides that if the S corporation has no accumulated earnings and profits, the amount distributed to a shareholder reduces the adjusted basis in the shareholder's stock. If the distribution exceeds the shareholder's basis, the excess is treated as a capital gain. If the S corporation has earnings and profits, the distribution is applied in the following order:

1. To the Accumulated Adjustments Account (AAA) which essentially includes the income during the period the corporation has been an S corporation reduced by its losses and distributions during that period. The AAA for State income tax purposes *does not* include the federal AAA for tax years beginning prior to January 1, 1989. The shareholder does not take into account distributions from the AAA in determining taxable income but such distributions reduce the adjusted basis of the shareholder's stock.

2. To Earnings and Profits (E and P): An S corporation is not considered to have earnings and profits for State tax purposes for years in which it operates as an S corporation after January

1, 1989. The E and P account basically includes the earnings and profits on hand from the period the corporation was a C corporation; and for State tax purposes, the E and P account also includes the undistributed earnings and profits of the S corporation from tax years beginning before January 1, 1989, (the federal AAA that existed on the day North Carolina began to measure the S corporation shareholder's income by reference to the income of the S corporation). The amount distributed to the shareholder from the E and P account is taxed to the shareholder as a dividend. Since the State E and P account includes the federal AAA that existed prior to the change in State law taxing the S corporation income to the shareholders, federal adjusted gross income must be increased for any distributions from the federal AAA that existed prior to the law change.

3. To the basis of the shareholder's stock. Any excess over the shareholder's basis is taxed as a capital gain.

A shareholder who makes an election for federal tax purposes to treat distributions from the S corporation as being paid first from earnings and profits may not make a different election for State purposes.

Reference: G.S. § 105-131.6; 17 NCAC 06B .4006.

8. Losses

The amount of loss a shareholder may deduct is limited to the adjusted basis of the shareholder's stock, plus the adjusted basis of any loans owed to the shareholder by the corporation. The amount of the loss for the taxable period is figured before the shareholder's basis in the stock is adjusted for any distributions during the tax year. If the amount of the loss of a shareholder is limited because it exceeds the adjusted basis, the excess is treated as incurred by the corporation in the next tax year.

Reference: G.S. § 105-131.4.

9. Foreign S Corporation

North Carolina income tax is required to be withheld from compensation paid to a foreign S corporation for certain personal services performed in North Carolina. For more information, see Withholding from Nonwage Compensation. If an S corporation has obtained a certificate of authority from the North Carolina Secretary of State, no income tax is required to be withheld if the S corporation provides to the payer the S corporation's identification number issued by the North Carolina Secretary of State.

An S corporation may claim credit on the S corporation franchise and income tax return, Form CD-401S, the portion of the income tax withheld attributable to a nonresident shareholder on whose behalf the S corporation files a composite return. The portion of the income tax withheld attributable to a nonresident shareholder who is not part of a composite return must be allocated to that shareholder on Schedule K of the S corporation return.

10. Time and Place for Filing an S Corporation Tax Return

An S Corporation doing business in North Carolina is required to file Form CD-401S on or before April 15 if on a calendar year basis and on or before the 15th day of the fourth month following the end of the fiscal year if on a fiscal year basis. If the tax return cannot be filed by the due date, the S corporation may apply for an automatic seven-month extension of time to file 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 income tax return. To receive an automatic State extension, the S corporation must certify on the North Carolina tax return that it was granted an automatic federal extension. If the S corporation is not granted an automatic federal extension, the S corporation must file Form CD-419, Application for Extension for Filing Corporate Income and Franchise Tax Return, by the due date of the return to receive a State extension. For information on when a document is considered timely filed, see Departmental Directive TA-16-1 and Departmental Directive TA-18-1.

For information on filing an Application for Extension for Filing an Individual Income Tax Return (Form D-410), see Extensions. For more information on filing an Individual Income Tax Return, see Form D-401.

Reference: G.S. § 105-131.7.

VIII. Estates and Trusts

1. North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust

On June 21, 2019, the United States Supreme Court held that the presence of "in-state beneficiaries alone does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it." 139 S. Ct. 2213, 2221 (2019). By contrast, the United States Supreme Court stated that taxation of trust income based on distributions of trust income to an in-state resident, a trustee's in-state residence, or in-state trust administration does not violate the Constitution. *Id.* at 2220.

Trusts with these or other connections to the State should carefully analyze those connections to determine if the connections are sufficient for the State to tax the entity's undistributed taxable income under the Due Process Clause. Income that is exempt from North Carolina tax under the United States Supreme Court's holding in *North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust* is excluded from North Carolina taxable income using line 6 of Form D-407.

2. General

All income of an estate or trust is taxed to the fiduciary or the beneficiary. The conduit rules for taxing estates and trusts are applicable for North Carolina income tax purposes. Under the conduit rules, regardless of who is taxed, the income retains its same character as when received by the estate or trust.

A trust is neither a resident nor a nonresident. A trust's North Carolina income tax liability is determined based, in part, on the situs of the income beneficiaries, not where the trust was established or where the trustee lives. North Carolina law requires the tax to be computed on the taxable income of the estate or trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (1) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (2) is derived from a business, trade, profession, or occupation carried on in this State.

Reference: G.S. § 105-160.

3. Income Tax Return for Estates and Trusts

a. Taxable Income

The federal taxable income of the estate or trust is the starting point for preparing a North Carolina Income Tax Return for Estates and Trusts, Form D-407, and requires the same additions and deductions to income as required for individuals.

Important. The fiduciary must determine the estate's or trust's federal taxable income before completing Form D-407. In addition, an estate and a trust must add to federal taxable income any state, local, or foreign income tax deducted on the federal estates and trusts return.

b. Fiduciary Responsibility

The fiduciary responsible for administering the estate or trust is responsible for filing the return and paying the tax. The fiduciary must file an income tax return for the estate or trust for which he acts if he is required to file a federal return for estates and trusts and (1) the estate or trust derives income from North Carolina sources or (2) the estate or trust derives any income which is for the benefit of a resident of North Carolina.

Note: The fiduciary of a foreign estate or trust has a requirement to file Form D-407, North Carolina Estates and Trusts Income Tax Return, even if the income tax return required to be filed with the IRS for the estate or trust is Form 1040-NR, U.S. Nonresident Alien Income Tax Return.

c. Grantor Trust Exception

With respect to a grantor trust return, North Carolina has access to the federal information contained in the federal grantor trust return. Therefore, a separate North Carolina estate and trust tax return is not required to be filed when the entire trust is treated as a grantor trust for federal income tax purposes.

d. Taxed Pass-Through Entity Ownership

For more information regarding an estate or trust that is an owner of a Taxed PTE, see Taxed Pass-Through Entities.

e. Form NC-PE and Form NC K-1 Supplemental Schedule

Use Form NC-PE to compute the North Carolina fiduciary adjustments to income. Generally, estates and trusts are subject to the adjustments allowed to individuals. Form NC-PE lists all the adjustments permitted by statute for an individual. Certain adjustments on Form NC-PE will not apply to estates or trusts.

Form NC K-1 Supplemental Schedule is used by the estate or trust to report to each beneficiary, the beneficiary's share of North Carolina adjustments reported by the estate or trust on Form NC-PE. Form NC-PE lists all the adjustments permitted by statute for an individual. To determine if a North Carolina adjustment applies to an estate or trust, the fiduciary must review applicable federal and State tax law.

Reference: G.S. § 105-160.2; G.S. § 105-160.5; 17 NCAC 06B .3716.

4. Time and Place for Filing an Estates and Trusts Tax Return

An estate or trust that is required to file a North Carolina tax return must file Form D-407 on or before April 15 if on a calendar year basis and on or before the 15th day of the fourth month following the end of the fiscal year if on a fiscal year basis. If the return cannot be filed by the due date, the fiduciary may apply for an automatic six-month extension of time to file the return. An estate or trust 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 income tax return. To receive an automatic State extension, the estate or trust must certify on the North Carolina tax return that it was granted an automatic federal extension. If the estate or trust is not granted an automatic federal extension, the estate or trust must file Form D-410P, Application for Extension for Filing Partnership, Estate, or Trust Tax Return, by the original due date of the return to receive an extension for North Carolina purposes.

For information on when a document is considered timely filed if the due date falls on a Saturday, Sunday, or legal holiday, see Departmental Directive TA-16-1 and Departmental Directive TA-18-1.

Reference: G.S. § 105-160.6, G.S. § 105-263.

5. Payment of Tax

The tax rate for estates and trusts is the same as the tax rate for an individual required to file a North Carolina individual income tax return. The tax due on the estate and trust tax return is payable in full by the due date of the return. For more information, see Tax Rate Schedules.

Reference: G.S. § 105-160.2.

6. Allocation of Adjustments

The additions and deductions required by G.S. § 105-153.5 and G.S. § 105-153.6 to the income of an estate or trust must be apportioned between the estate or trust and the beneficiaries based on the distributions of income made during the taxable year. If the trust instrument or will that created the estate or trust does not provide for the distribution of certain classes of income to different beneficiaries, the apportionment of additions and deductions to the beneficiaries is determined on the basis that each beneficiary's share of the estate's or trust's "total income," the sum of lines 1 through 8 on the beneficiary's Schedule K-1, federal Form 1041, relates to adjusted total income from line 17 of federal Form 1041. If the trust instrument or will specifically provides for the distribution of certain classes of income to different beneficiaries, any addition or deduction directly attributable to a particular class of income must be apportioned to the beneficiaries to which that class of income is distributed. In allocating the adjustments for North Carolina purposes, the amount of "total income" on federal Schedule K-1 must be adjusted for distributions to the beneficiary that are not reflected in "total income." The adjusted total income on federal Form 1041 must be adjusted (1) to exclude classes of income that are not part of the distribution to the beneficiary; (2) to include classes of income that are a part of the distribution to the beneficiary which are not included in adjusted total income; and (3) by any deduction treated differently for North Carolina and federal tax purposes that adjust income pursuant to G.S. § 105-153.5 and G.S. § 105-153.6. After apportioning the additions and deductions to the beneficiaries, the balance is apportioned to the fiduciary.

Reference: 17 NCAC 06B .3723.

7. Allocation of Income Attributable to a Nonresident Beneficiary

If the estate or trust has income from sources outside of North Carolina and if any of the beneficiaries are nonresidents of North Carolina, the portion of federal income of the fiduciary that is subject to North Carolina tax must be determined. If there is no gross income from dividends, interest, other intangibles, or from sources outside North Carolina for the benefit of a nonresident beneficiary, the total income of the estate or trust is taxable to the fiduciary.

The determination of the amount of undistributed income from intangible property which is for the benefit of a resident is based on the beneficiary's state of residence on the last day of the taxable year of the trust. In the case of both resident and nonresident beneficiaries, the determination of the amount of undistributed income from intangible property which is for the benefit of a resident is made on the basis that the resident beneficiary's interest for the taxable year relates to the interest of both resident and nonresident income beneficiaries for the taxable year.

Reference: 17 NCAC 06B .3724.

8. Tax Credits

Estates and trusts are allowed all tax credits allowed to individuals except for the tax credit for income taxes paid by individuals to other states or countries.

Form D-407TC, Estates and Trusts Tax Credit Summary, is used to report any tax credits claimed on an estate or trust return. The amounts reflected on "Form D-407TC" are the portions of the tax credits allocated to the trust or estate. A fiduciary required to pay an income tax to North Carolina for a trust for which he acts may claim a credit for income tax imposed and paid to another state or country on income from sources within that state or country under the provisions of G.S. § 105-160.4(a).

Part 5 of Form D-407TC is used in computing the tax credit allowable to the estate or trust. Before this schedule may be completed, there must be an allocation between the estate or trust and its beneficiaries of the tax paid and the gross income on which such tax was paid to the other state or country.

If the fiduciary is required to pay income tax to another state or country on the income that is includable in the resident beneficiary's gross income, a resident beneficiary of an estate or trust may claim a credit against the resident beneficiary's North Carolina income tax for the resident beneficiary's share of tax paid to the other state or country under the provisions of G.S. § 105-160.4(e).

The fiduciary's share and each beneficiary's share of the gross income on which tax has been paid to another state or country is determined by the governing instrument and should be entered in the appropriate schedule on the return. The fiduciary's share of gross income to be used in the tax credit computation schedule is the total gross income from federal Form 1041.

For an estate or trust which is an owner of a pass-through entity, see Credit for Tax Paid by an S Corporation or Partnership to another State or Country. For an estate or trust which is an owner of a Taxed Pass-Through Entity, see Taxed Pass-Through Entities.

Reference: G.S. § 105-160.3; 17 NCAC 06B .3714.

IX. Tax Credits

1. Preliminary Statement on Taxed Pass-Through Entities

Sections G.S. § 105-131.1A(c) and section G.S. § 105-154.1(c) provide special rules to Taxed S Corporations and Taxed Partnerships that qualify for a tax credit. For more information, see Taxed Pass-Through Entities.

2. Overview

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

Reference: Articles 3A, 3B, 3D, 3E, 3F, 3G, 3H, 3J, 3K, 3L and 4.

a. Effect on Installments and Carryforwards

A taxpayer that qualified for a tax credit that is repealed 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. Forms

Form D-400TC is used to report tax credits that are not limited to fifty percent (50%) of the tax. Form NC-478 is used to report tax credits that are limited to fifty percent (50%) of tax The Form NC-478 series is used to calculate and report the tax credit that is limited to fifty percent (50%) of the tax.

Form D-400TC and, if applicable, Form NC-478 must be filed for any taxable year in which the taxpayer is eligible to claim a tax credit, take a tax credit, or take an installment of a tax 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 tax credit.

3. Article 4 - Tax Credit for Income Taxes Paid to Another State or Country

a. Tax Credit for Income Taxes Paid by Individual

A tax credit is allowed to an individual who is a resident of North Carolina for tax imposed by and paid to another state or country on income that is also taxed by North Carolina, subject to the following conditions:

1. The income must have been derived from sources in the other state or country and must have been taxed under the laws of that state or country, regardless of the legal residence of the taxpayer.

2. The credit allowable is the smaller of either the net tax paid the other state or country on income also taxed by North Carolina or the product obtained by multiplying the North Carolina tax computed before credit by a fraction in which the numerator is the part of the North Carolina income, as adjusted, which is taxed in the other state or country and the denominator is the total income, as adjusted, received while a resident of North Carolina. If credits are claimed for taxes paid to more than one state or country, a separate computation must be made for each state or country and the separate credits combined to determine the total credit.

3. Receipt or other proof showing payment of income tax to the other state or country and a copy of the return filed with the other state or country must be submitted with the North Carolina return. No credit is allowed for income taxes paid to a city, county, or other political subdivision of a state or country or to the federal government. Some foreign countries do not require individuals to file income tax returns. Instead, their income tax liability is paid through withholding. The Department will accept evidence of the withholding to substantiate the tax credit.

If any tax for which a resident has claimed a tax credit on the North Carolina income tax return is refunded at any time by the other state or country, a tax equal to that portion of the credit allowed for the taxes credited or refunded is due and payable from the taxpayer and is subject to penalties and interest.

Note: The tax credit for income taxes paid to other states allowed under G.S. § 105-153.9 is not a refundable tax credit. As such, the tax credit may not exceed the amount of tax imposed on the taxpayer for the taxable year reduced by the sum of all other tax credits allowed, except payments of tax made by or on behalf of the taxpayer.

The tax credit allowed to a North Carolina resident is determined as follows:

$$\frac{\text{Portion of total federal income while a resident of N.C., as adjusted, that was taxed by another state or country}}{\text{Total federal income while a resident of N.C., as adjusted}} \times \text{N.C. income tax} = \text{Tax credit}$$

After making the computation by use of this formula, the tax credit allowed is either the credit obtained by use of the formula or the actual amount of net income tax paid to the other state or country, whichever is smaller.

Example 1. A full-year resident of North Carolina files a 2025 North Carolina individual income tax return as a single individual. The taxpayer's total federal gross income and federal adjusted gross income are $40,000. The taxpayer worked temporarily in South Carolina, earning $5,000 on which he paid $131 in income tax to South Carolina. Taxpayer claimed the N.C. standard deduction. The credit against his North Carolina income tax is determined as follows:

Federal adjusted gross income ....$ 40,000

Less: N.C. standard deduction .... (12,750)
North Carolina taxable income ....$ 27,250
North Carolina tax...$1,158

Less tax credit:

Portion of total federal income, while a resident of N.C., as adjusted, taxed by South Carolina	$5,000	x	$1,158	=	$145
Total federal income while a resident of N.C., as adjusted	$40,000				

Since the $131 income tax paid to South Carolina is less than the computed North Carolina income tax credit of $145, the allowable North Carolina income tax credit is the actual tax paid to South Carolina. Therefore, the North Carolina tax due for the full-year resident is $1,027 ($1,158 – $131).

Example 2. Two lawfully married individuals are both residents of North Carolina and file a joint 2025 North Carolina individual income tax return. The taxpayer's federal gross income and federal adjusted gross income is $40,000, of which $5,500 was received from rental property in Virginia that is owned by both spouses. One spouse earned $2,000 for temporary employment in South Carolina. The taxpayers claimed the N.C. standard deduction. The taxpayers paid $290 in income tax on the income earned in Virginia and only one spouse paid $102 in income tax on the income earned in South Carolina. The credit against North Carolina income tax is determined as follows:

Federal adjusted gross income $40,000
Less: N.C. standard deduction ....(25,500)
North Carolina taxable income ....$ 14,500

North Carolina tax... $616

Less tax credit:

Portion of total federal income, while a resident of N.C., as adjusted, taxed by Virgina	$5,500	x	$616	=	$ 85
Total federal income while a resident of N.C., as adjusted	$40,000				

Since the $290 income tax paid to Virginia is more than the computed North Carolina income tax credit of $85, the allowable North Carolina income tax credit is $85.

Portion of total federal gross income while a resident of N.C., as adjusted, taxed by South Carolina	$2,000	x	$616	=	$ 31
Total federal income while a resident of N.C., adjusted	$40,000				

Since the $102 income tax paid to South Carolina is more than the computed North Carolina income tax credit of $31, the allowable North Carolina income tax credit is $31. Therefore, the North Carolina tax due is $500 ($616-$85-$31).

Example 3. A taxpayer became a North Carolina resident on June 1, 2025. Prior to moving to North Carolina, the taxpayer earned $4,000 in South Carolina. From June 1 through December 31, the taxpayer earned $6,000 in South Carolina and $10,000 in North Carolina. The taxpayer paid $150 in income tax to South Carolina on the $10,000 in income earned in South Carolina. The taxpayer claimed the N.C. standard deduction for a single individual. The credit against North Carolina income tax is determined as follows:

Federal adjusted gross income $20,000
Less: N.C. standard deduction ....(12,750)
North Carolina taxable income before part-year resident adjustment $7,250

Total federal gross income, while a N.C. resident, plus
total income from N.C. sources while a nonresident, adjusted $16,000 x $7,250 = $5,800
Total federal gross income from all sources, adjusted $20,000

North Carolina income tax on $5,800 .... $247

Less tax credit:
Portion of total federal gross income, while a N.C. resident,
as adjusted, taxed by South Carolina $6,000 x $247 = $93*
Total federal income while a resident of N.C, as adjusted $16,000

* *(The computed North Carolina income tax credit is determined only with respect to income while the taxpayer is a resident of North Carolina.)*

Income earned in South Carolina taxed by N.C. $6,000 x $150 = $90**
Total South Carolina income $10,000

** *(Since a part of the tax paid to South Carolina was on income not taxed by North Carolina, this computation is necessary to determine the portion of South Carolina tax that was paid on income also taxed by North Carolina.)*

Since the $90 paid to South Carolina on income also taxed by North Carolina is less than the computed North Carolina income tax credit of $93, the allowable North Carolina income tax credit is $90. Therefore, the North Carolina tax due for the taxpayer is $157 ($247-$90).

Reference: G.S. § 105-153.9; 17 NCAC 06B .0607.

b. Tax Credit for Income Taxes Paid by an S Corporation or Partnership

G.S. § 105-153.9(d) allows a resident partner in a partnership that pays entity-level income tax in another state or the District of Columbia but does not elect to be Taxed Partnership to include the partner's distributive share of entity-level income taxes paid by the partnership to the other state or the District of Columbia when computing the tax credit for income taxes paid to other states.

G.S. § 105-153.9(e) allows a resident shareholder in an S Corporation that pays entity-level income tax in another state or the District of Columbia but does not elect to be Taxed S Corporation to include the shareholder's pro rata share of entity-level income taxes paid by the S Corporation to the other state or the District of Columbia when computing the tax credit for income taxes paid to other states.

Note: No tax credit is allowed under G.S. § 105-153.9 for taxes paid to another state or the District of Columbia on income eligible for the deduction provided in G.S. 105-153.5(c3). See Taxed Pass-Through Entities for more information.

Reference: G.S. § 105-153.9.

c. Tax Credits for Income Taxes Paid by a Taxed Pass-Through Entity

No tax credit is allowed under G.S. § 105-153.9 for taxes paid to another state or the District of Columbia on income eligible for the deduction provided in G.S. 105-153.5(c3). See Taxed Pass-Through Entities for more information.

Reference: G.S. § 105-153.9.

d. Tax Credit for Certain Real Property Donations (NC Conservation Tax Credit)

Subject to limitations, an eligible individual or pass-through entity that makes a qualified donation is allowed a tax credit equal to 25% of the fair market value of the qualified donation. A pass-through entity must pass through the credit to its owners as required under G.S. 105-153.11(f). The credit may not 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 tax credit becomes effective as provided in G.S. 105-153.11(c).

For more information, see the Department's Directive TA-25-1.

Reference: G.S. § 105-153.11. Session Law 2025-4.

4. Article 3H - Credit for Mill Rehabilitation

Session Law 2020-180 reenacted Article 3H as it existed immediately before its repeal. The Article now expires for rehabilitation projects not completed and placed in service prior to January 1, 2030. For more information, see the Department's 2021 Tax Law Changes publication and the Corporate Income Tax Bulletin.

Reference: Article 3H; Session Law 2020-180.

5. Article 3L - Historic Rehabilitation Tax Credits

a. General

Article 3L is effective for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2016.

Reference: Article 3L.

1. Tax Credited

The tax credits provided in Article 3L are allowed against franchise tax, income tax, or gross premiums tax. The taxpayer must elect the tax against which the tax credit will be claimed when filing the tax return on which it is claimed. Any future carryforwards of unused tax credits must be claimed against the same tax.

Reference: G.S. § 105-129.108(a).

2. General Credit Limitations

A tax credit allowed may not exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all tax credits allowed, except payments of tax made by or on behalf of the taxpayer. A taxpayer claiming a tax credit under Article 3L may not also claim a tax credit under Article 3D or Article 3H with respect to the same activity. Any unused portion of a tax credit may be carried forward for the succeeding nine (9) years.

Reference: G.S. § 105-129.108(c).

3. Forms

A taxpayer must claim the historic rehabilitation tax credit on the tax return filed for the taxable year in which the certified historic structure is placed into 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 tax credit. For more information, see the Instructions for Form NC-Rehab.

In addition, Form D-400TC is used to report any tax credits claimed under this Article. This form must be filed for any taxable year in which a tax credit or a carryover of a tax credit against the taxpayer's tax liability for that year is claimed. When an income-producing property is placed into service in two or more phases in different tax years, the amount of tax credit is based on the expenditure amount associated with the phase placed into service during the respective tax year.

Reference: G.S. § 105-129.108(b).

4. Rules and Fees

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.

Reference: G.S. § 105-129.107.

5. Sunset

Article 3L expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2030. For qualified expenditures and rehabilitation expenses incurred prior to January 1, 2030, the Article expires for property not placed in service by January 1, 2032.

Reference: G.S. § 105-129.110.

b. Credit for Rehabilitating Income-Producing Historic Structure

1. Tax Credit

A taxpayer who 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 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 in which the credit, or a carryforward of the credit, is claimed. For a certified historic structure used for multiple purposes, the bonus provided is proportionate to the area of the certified historic structure used for an educational purpose.

For purposes of this 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 a certification obtained from the State Historic Preservation Officer, defined in G.S. § 105-129.105(c)(7). "Educational purpose" is defined as 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.

Reference: G.S. § 105-129.105(a).

2. Credit Limitation

The total amount of credit allowed for qualified rehabilitation expenditures for an income-producing certified historic structure may not exceed 4.5 million dollars.

Reference: G.S. § 105-129.105(d).

3. Allocation from a Pass-Through Entity

Notwithstanding the provisions of G.S. § 105-131.8 and G.S. § 105-269.15, a pass-through entity that qualifies for the tax credit may allocate the tax credit among any of its owners at its discretion as long as an owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the certified historic structure is placed in service, is at least forty percent (40%) of the amount of tax credit allocated to that owner. Owners to whom a tax credit is allocated are allowed the tax credit as if they had qualified for the tax credit directly. A pass-through entity and its owners must include a statement of the allocation made by the pass-through entity and the allocation that would have been required under G.S. § 105-131.8 or G.S. § 105-269.15 with their tax returns for every taxable year in which an allocated tax credit is claimed. A pass-through entity is defined in G.S. § 105-228.90.

Reference: G.S. § 105-129.105(b).

4. Forfeiture for Disposition

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 tax credit allowed with respect to that historic structure. If the tax credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the tax credit was allowed.

Reference: G.S. § 105-129.108(d).

5. Forfeiture for Change in Ownership

If an owner of a pass-through entity that has qualified for the tax credit allowed under G.S. § 105-129.105 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 tax 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.

Reference: G.S. § 105-129.108(e).

6. Exceptions to Forfeiture

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.

Reference: G.S. § 105-129.108(f).

7. Liability from Forfeiture

A taxpayer or an owner of a pass-through entity that forfeits a tax credit under this section is liable for all past taxes avoided as a result of the tax 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 tax credit were not allowed. The past taxes plus interest are due 30 days from the date the tax 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.

Reference: G.S. § 105-129.108(g).

8. Substantiation

A taxpayer claiming this tax 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 tax credit claimed.

Reference: G.S. § 105-129.108(h).

c. Credit for Rehabilitating Non-Income-Producing Historic Structure

1. Tax Credit

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 tax 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. § 105-129.106(c)(5), as contributing to the historic significance of a National Register Historic District or locally district certified by the U.S. Department of the Interior.

Reference: G.S. § 105-129.106(a).

2. Limitations

The amount of tax 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 allowed a tax credit for the rehabilitation expenses made by the transferor only if the transfer occurs before the structure is placed in service. In such a case, the transferor must provide the transferee with documentation detailing the amount of rehabilitation expenses and tax credit. The transferee is the only taxpayer that may claim the tax 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 tax credit for rehabilitating a non-income-producing historic structure once during any five-year period, not including carryovers.

Reference: G.S. § 105-129.106(b).

3. Substantiation

The tax credit for rehabilitating a non-income-producing historic structure is claimed in the taxable year in which the property is placed in service. Any unused portion of the tax credit may be carried forward for the succeeding nine years.

Reference: G.S. § 105-129.108(h).

X. Withholding of Income Tax

1. General

G.S. § 105-163.1 through G.S. § 105-163.10, G.S. § 105-163.16, and G.S. § 105-163.22 through G.S § 105-163.24 require employers, pension payers, and other payers to withhold income tax from payments of wages, nonwage compensation, pensions, and lottery winnings.

Reference: Article 4A.

2. Withholding From Wages

a. General

Income tax must be withheld according to tables prepared by the Department or by using an acceptable alternate method and employers must pay over the amount withheld to the Department. The requirements are explained in Publication NC-30, Income Tax Withholding Tables and Instructions for Employers.

“Wages” is defined for North Carolina withholding purposes as having the same meaning as in section 3401 of the Code. Wages paid to certain nonresident employees engaged in disaster relief work at the request of a critical infrastructure company are excluded from the withholding requirements of G.S. § 105-163.2 and employers are not required to withhold state income taxes from the wages paid to these employees. See Critical Infrastructure Disaster Relief Work for additional information.

If an employer enters into a voluntary agreement to withhold North Carolina tax on income not requiring withholding, the amount withheld will be accepted and the employee will receive credit on the annual income tax return provided the rules which apply to withholding are followed. Since the agreement to withhold is voluntary between the employer and the employee and is not required by law, the employee cannot receive credit for any amount withheld that is not properly paid to the Department of Revenue.

Reference: G.S. § 105-163.1; G.S. § 105-163.2.

b. Annual Statements

1. Informational Return to Secretary

Every employer who is required to or voluntarily withholds North Carolina income taxes must file Form NC-3, Annual Withholding Reconciliation, and the required W-2 and 1099 statements (collectively “Form NC-3”). Form NC-3 must be filed in an electronic format as prescribed by the Secretary. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State’s copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the eNC3 and Information Reporting Application located on the Department’s website.

Note: If Form NC-3 is not filed in the format prescribed by the Secretary, the Department will assess a penalty against the employer as prescribed under G.S. § 105-236(a)(10)(d) for failure to file Form NC-3 in the format prescribed by the Secretary.

Unless an employer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed with the Department on or before January 31 for the preceding calendar year. During the calendar year, if an employer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed on or before the last day of the month following the end of the calendar quarter in which the employer terminates its business, but no later than January 31 of the succeeding year. If an employer does not timely file Form NC-3 either electronically or by paper on or before the due date, the Secretary will impose a failure to timely file penalty against the employer as prescribed under G.S. § 105-236(a)(10)(c).

Note: A request to waive the failure to timely file an informational return penalty will affect an employer's good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department's Penalty Waiver Policy) allows every taxpayer one penalty waiver for most tax types every three years.

For additional details, see Reporting and Paying Tax Withheld.

Reference: G.S. § 105-163.7; G.S. § 105-236(a)(10); G.S. § 105-228.90, 17 NCAC 06C .0203.

2. Report to Income Recipients

Every employer who is required to or voluntarily withholds North Carolina income taxes from wages, nonwage compensation, or pension payments must furnish the recipient of the income a form or statement that reports the remuneration paid by the employer to the recipient during the calendar year, the total amount deducted and withheld from the remuneration, the employer's identification information, and the recipient's identification information. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if an employer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For additional details, see Reporting and Paying Tax Withheld.

Reference: G.S. § 105-163.7; G.S. § 105-228.90; 17 NCAC 06C .0203.

3. Withholding From Pensions, Annuities, and Deferred Compensation

a. General

A pension payer required to withhold federal tax under section 3405 of the Code on a pension payment to a North Carolina resident must also withhold State income tax from the pension payment. If a payee has provided a North Carolina address to a pension payer, the payee is presumed to be a North Carolina resident and the payer is required to withhold State tax unless the payee elects no withholding. A pension payer that either fails to withhold or to remit tax that is withheld is liable for the tax.

A pension payer must treat a pension payment paid to an individual as if it were an employer's payment of wages to an employee. If the pension payer has more than one arrangement under which distributions may be made to an individual, each arrangement must be treated separately.

Reference: G.S. § 105-163.2A.

b. Definitions

Unless otherwise specified below, the definitions, provisions, and requirements of section 3405 of the Code with respect to federal withholding on pensions are applicable to State withholding on pensions.

Pension payer. A payer or a plan administrator with respect to a pension payment under section 3405 of the Code.

Pension payment. A periodic payment or a nonperiodic distribution as those terms are defined in section 3405 of the Code.

Reference: G.S. § 105-163.2A(a).

c. Amount to Withhold

In the case of a **periodic payment,** as defined in Code section 3405(e)(2), the payer must withhold as if the recipient were single with no allowances unless the recipient provides an exemption certificate, Form NC-4P, Withholding Allowance Certificate for Pension or Annuity Payments, reflecting a different filing status or number of allowances. Form NC-4P is used by a recipient of pension payments who is a North Carolina resident to report the correct filing status, number of allowances, and any additional amount the recipient wants withheld from the pension payment. It may also be used to elect not to have State income tax withheld. In lieu of Form NC-4P, payers may use a substitute form if it contains all the provisions included on Form NC-4P.

For a **nonperiodic distribution**, as defined in Code section 3405(e)(3), other than an eligible rollover distribution, federal law imposes withholding at the rate of ten percent

(10%) of the distribution. If the nonperiodic distribution is an eligible rollover distribution, federal law requires twenty percent (20%) of the distribution to be withheld. Federal law imposes a higher rate of withholding on eligible rollover distributions than on other nonperiodic distributions. State law imposes the same rate of withholding on all nonperiodic distributions. For State purposes, a payer must withhold four percent (4%) of any nonperiodic distribution unless one of the two exceptions explained below applies.

Exception 1. If the nonperiodic distribution is not an eligible rollover distribution, the recipient may elect not to have State tax withheld if the recipient is permitted to elect not to have federal income tax withheld from the distribution. The election not to have State tax withheld may be made even if the recipient did not elect to not have federal tax withheld.

Exception 2. If the nonperiodic distribution is an eligible rollover distribution, State tax withheld is not required on a distribution paid in a direct rollover to an eligible retirement plan, including an IRA. Otherwise, the recipient cannot elect not to have State tax withheld from an eligible rollover distribution.

Reference: G.S. § 105-163.2A(c).

d. Election Not to Have Income Tax Withheld

An election not to have income tax withheld from a pension payment remains in effect until revoked by the recipient. An election not to have income tax withheld is void if the recipient does not furnish the recipient's tax identification number to the payer or furnishes an incorrect identification number. In such cases, the payer will withhold on periodic payments as if the recipient is single with no allowances and on nonperiodic distributions at the rate of four percent (4%).

A nonresident with a North Carolina address should also use Form NC-4P to elect not to have State income tax withheld. Completing Form NC-4P and electing not to have State tax withheld does not infer that the recipient is a resident of North Carolina.

Reference: G.S. § 105-163.2A(d).

e. Exceptions to Withholding

Tax is not required to be withheld from the following pension payments:

1. A pension payment that is wages.

2. Any portion of a pension payment that meets both of the following conditions:

   - It is not a distribution or payment from an individual retirement plan as defined in section 7701 of the Code.
   - The pension payer reasonably believes it is not taxable to the recipient.

3. A distribution described in section 404(k)(2) of the Code, relating to dividends on corporate securities.

4. A pension payment that consists only of securities of the recipient's employer corporation plus cash not in excess of $200 in lieu of securities of the employer corporation.

5. Distributions of retirement benefits received from North Carolina State and local government retirement systems and federal retirement systems identified as qualifying retirement systems under the terms of the *Bailey/Emory/Patton* settlement that are paid to retirees who were vested in the retirement systems as of August 12, 1989. For more information, see Bailey Settlement.

6. Distributions from the United States government for retirement payments for service in the uniformed services of the United States made to a retired member that served at least 20 years or medically retired under 10 U.S.C. Chapter 61. This exemption does not apply to severance pay received by a member due to separation under 10 U.S.C. Chapter 61. The exemption is also available for a beneficiary of an eligible retired member for payments made to the beneficiary from a Plan defined in 10 U.S.C. § 1447.

   Reference: G.S. § 105-163.2A(e); G.S. § 105-153.5(b)(5).

f. Notification Procedures for Pension Payers

A pension payer is required to provide each recipient with notice of the right not to have State withholding apply and of the right to revoke the election. The notice requirements for North Carolina purposes are the same as the federal notice requirements, which are provided in section 3405(e)(10) of the Code. Section D of Federal Regulation 35.3405-1T contains sample notices that may be modified for State purposes to satisfy the notice and election requirements for periodic payments and nonperiodic distributions. Instead of notification that tax will be withheld unless the recipient chooses not to have tax withheld, pension payers may notify recipients whose annual payments are less than $12,750 that no State income tax will be withheld unless the recipient chooses to have State withholding apply. Such notice may be provided when making the first payment.

g. Reporting and Paying the Withheld Tax

A pension payer that is required to withhold State income tax from a pension payment but is not already registered with the Department of Revenue for wage withholding must register to obtain a withholding account identification number. The registration can be completed on the Department's website, or by completing Form NC-BR, Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Other Taxes and Service Charge. The payer will be assigned an account identification number that should be recorded in a permanent place and used on all reports and correspondence related to State income tax withholding. A pension payer will initially be classified as a quarterly filer. The filing frequency may change after the first year depending on the amount of income tax withheld during the first year.

A payer that withholds tax from pensions and also withholds tax from wages must report the withholding from pensions with the wage withholding unless the payer chooses to report the withholding from pensions separately. For those payers that do not choose to report the two types of withholding separately, the payment of income tax withheld from pensions is due at the time the withholding from wages is due and the payer will be subject to penalties and interest on both types of withholding based on that due date. Payers that also withhold from wages but choose to report the withholding from pensions separately must file Form NC-BR to receive a separate account identification number.

A payer that initially chooses to report withholding from pensions separately may, at any time begin reporting the two types of withholding together. If combined reporting is preferred, a payer should report the combined withholding under the account identification number for reporting wages. The payer should complete Form NC-BN, Out-of-Business Notification, for the separate pension withholding account and file it with the Department. The separate withholding account will be closed. A payer that initially reports the two types of withholding at the same time may choose to begin reporting the withholding on pensions separately by notifying the Department's Business Registration Unit. The payer must continue to report the two types of withholding together until the payer receives the separate account identification number from the Department. In either case, the payer must file separate annual reconciliations for the year in which the choice is changed.

h. Annual Statements

1. Informational Return to Secretary

Every pension payer who is required to or voluntarily withholds North Carolina income taxes must file Form NC-3, Annual Withholding Reconciliation, and the required W-2 and 1099 statements (collectively "Form NC-3"). Form NC-3 must be filed in an electronic format as prescribed by the Secretary. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State's copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the eNC3 and Information Reporting Application located on the Department's website.

Note: If Form NC-3 is not filed in the format prescribed by the Secretary, the Department will assess a penalty against the pension payer as prescribed under G.S. § 105-236(a)(10)(d) for failure to file Form NC-3 in the format prescribed by the Secretary.

Unless a pension payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed with the Department on or before January 31 for the preceding calendar year. During the calendar year, if a pension payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed on or before the last day of the month following the end of the calendar quarter in which the pension payer terminates its business, but no later than January 31 of the succeeding year. If a pension payer does not timely file Form NC-3 either electronically or by paper on or before the due date, the Secretary will impose a failure to timely file penalty against the pension payer as prescribed under G.S. § 105-236(a)(10)(c).

Important: A request to waive the failure to timely file an informational return penalty will affect a pension payer's good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department's Penalty Waiver Policy) allows every taxpayer one penalty waiver for most tax types every three years.

For additional details, see Reporting and Paying Tax Withheld.

Reference: G.S. § 105-163.2A; G.S. § 105-163.7; G.S. § 105-236(a)(10); G.S. § 105-228.90; 17 NCAC 06C .0203.

2. Report to Income Recipients

Every pension payer who is required to or voluntarily withholds North Carolina income taxes from wages, nonwage compensation, or pension payments must furnish the recipient of the income a form or statement that reports the remuneration paid by the pension payer to the recipient during the calendar year, the total amount deducted and withheld from the remuneration, the pension payer's identification information, and the recipient's identification information. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if a pension payer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For additional details, see Reporting and Paying Tax Withheld.

Reference: G.S. § 105-163.2A; G.S. § 105-163.7; G.S. § 105-236(a)(10); G.S. § 105-228.90; 17 NCAC 06C .0203.

4. Withholding from Nonwage Compensation

a. General

North Carolina income tax of four percent (4%) is required to be withheld from nonwage compensation paid to a payee. A payee is defined as any of the following:

1. A nonresident contractor. A nonresident contractor is either of the following:

    a. A nonresident individual who performs in this State for compensation other than wages any personal services in connection with a performance, an entertainment, an athletic event, a speech, or the creation of a film, radio, or television program.

b. A nonresident entity that provides for the performance in this State for compensation of any personal services in connection with a performance, an entertainment, an athletic event, a speech, or the creation of a film, radio, or television program.

2. An ITIN contractor. An ITIN is a nine-digit individual taxpayer identification number issued by the Internal Revenue Service. IRS Publication 1915 states that an ITIN is a nine-digit number beginning with the number "9", has a range of numbers from "50" to "65", "70" to "88", "90" to "92" and "94" to "99" for the fourth and fifth digits and is formatted like a SSN (i.e. 9XX-XX-XXXX).The withholding requirement applies not only to a person whose taxpayer identification number is an ITIN, but also to a person who has applied for an ITIN number and a person whose ITIN number has expired. For more information on the ITIN program, visit the IRS website.

3. A person who performs services in this State for compensation that fails to provide the payer a taxpayer identification number.

4. A person who performs services in this State for compensation that fails to provide the payer a valid taxpayer identification number ("TIN"). The Department must notify the payer that the TIN is invalid. If the Department notifies a payer that a payee's TIN is not valid, the withholding requirement applies to any compensation paid to that payee on or after that date.

   The requirement to withhold applies to payers who, in the course of a trade or business, expect to pay more than one thousand five hundred dollars ($1,500) of nonwage compensation to a payee during a calendar year.

b. Exceptions to Withholding

Tax is not required to be withheld from compensation paid to a nonresident entity if the entity meets certain requirements. No tax is required to be withheld if the entity is a corporation or a limited liability company that has obtained a certificate of authority from the Secretary of State. The payer must obtain from the entity and retain in its records the entity's Secretary of State ID Number.

No tax is required to be withheld from an entity that is exempt from North Carolina corporate income tax under G.S. § 105-130.11. This includes any organization that is exempt from federal income tax under the Internal Revenue Code. The entity must provide documentation of this tax exemption to the payer, such as a copy of the organization's federal determination letter of tax exemption or a copy of a letter of tax exemption from the Department.

If an entity is a partnership, no tax is required to be withheld if the partnership has a permanent place of business in this State. The payer must obtain from the partnership and retain in its records the partnership's address and taxpayer identification number.

Tax is not required to be withheld from personal services paid to an individual who is an ordained or licensed member of the clergy or who is a resident of North Carolina. If the payer does not withhold income tax because the individual is a resident of this State, the payer must retain the individual's address and social security number in its records.

Tax is not required to be withheld from compensation paid to an ITIN holder who is temporarily admitted to the United States to perform agricultural labor or services under an H-2A visa as described by 8 U.S.C. § 1101(a)(15)(H)(ii)(a) and who is not subject to federal income tax withholding under section 1441 of the Code (these individuals are commonly referred to as H-2A agricultural workers). 8 U.S.C. § 1101(a)(15)(H)(ii)(a) reads as follows: "[A]n alien having a residence in a foreign country which he has no intention of abandoning who is coming temporarily to the United States to perform agricultural labor or services, as defined by the Secretary of Labor in regulations and including agricultural labor defined in section 3121(g) of title 26, agriculture as defined in section 203(f) of title 29, and the pressing of apples for cider on a farm, of a temporary or seasonal nature."

For more information, see Departmental Directive TA-19-1.

Reference: G.S. § 105-163.3; G.S. § 105-163.1.

c. Withholding Threshold

Withholding is required if the payee is expected to be paid more than $1,500 during the calendar year. If the payment to a payee is $1,500 or less and, at the time the payment is made, the payer does not believe that the total compensation to be paid to the payee during the year will exceed $1,500, tax is not required to be withheld. If additional compensation paid to the payee later in the year causes total compensation for the year to exceed $1,500, the payer is not required to withhold tax from the additional compensation to make up for the compensation from which no tax was withheld.

Example 1. *A payer pays a payee $900 in January 2026 and does not expect to make any future payments to the payee.*

Because the payment is less than $1,500, no withholding is required.

Example 2. *The payer from Example 1 pays the same payee $800 in September 2026.*

The payer must withhold $32 from the $800 compensation ($800 x 4%) because the total compensation paid to the payee for the year now exceeds $1,500.

Example 3. *A payer pays a payee $1,000 in January 2026 and expects to make future payments to the same payee throughout the year, which are expected to equal or exceed $1,500.*

The payer must withhold $40 from the $1,000 compensation ($1,000 x 4%) because the total compensation paid to the payee for the year is expected to equal or exceed $1,500.

For more information, see Departmental Directive TA-19-1.

Reference: G.S. § 105-163.3; G.S. § 105-163.1.

d. Reporting and Paying the Withheld Tax

A payer that is required to withhold State income tax from nonwage compensation but is not already registered with the Department for wage withholding must register to obtain a withholding account identification number. The registration can be completed on the Department's website, or by completing Form NC-BR, Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Other Taxes and Service Charge. The payer will be assigned an account identification number that should be recorded in a permanent place and used on all reports and correspondence related to State income tax withholding. The payer will receive a letter from the Department that will include the payer's initial filing frequency. The filing frequency may change after the first year depending on the amount of income tax withheld during the first year.

A payer that withholds tax from nonwage compensation and also withholds tax from wages must report the withholding from nonwage compensation with the wage withholding unless the payer chooses to report the withholding from nonwage compensation separately. For those payers that do not choose to report the two types of withholding separately, the payment of income tax withheld from nonwage compensation is due at the time the withholding from wages is due and the payer will be subject to penalties and interest on both types of withholding based on that due date. Payers that also withhold from wages but choose to report the withholding from nonwage compensation separately must file Form NC-BR to receive a separate account identification number.

A payer that initially chooses to report withholding from nonwage compensation separately may, at any time begin reporting the two types of withholding together. If combined reporting is preferred, a payer should report the combined withholding under the account identification number for reporting wages. The payer should complete Form NC-BN, Out-of-Business Notification, for the separate nonwage compensation withholding account and file it with the Department. The separate withholding account will be closed. A payer that initially reports the two types of withholding at the same time may choose to begin reporting the withholding on nonwage compensation separately by notifying the Department's Business Registration Unit. The payer must continue to report the two types of withholding together until the payer receives the separate account identification number from the Department. In either case, the payer must file separate annual reconciliations for the year in which the choice is changed.

e. Annual Statements

1. Informational Return to Secretary

Every payer who is required to or voluntarily withholds North Carolina income taxes must file Form NC-3, Annual Withholding Reconciliation, and the required W-2 and 1099 statements (collectively "Form NC-3"). Form NC-3 must be filed in an electronic format as prescribed by the Secretary. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State's copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the eNC3 and Information Reporting Application located on the Department's website.

Note: If Form NC-3 is not filed in the format prescribed by the Secretary, the Department will assess a penalty against the payer as prescribed under G.S. § 105-236(a)(10)(d) for failure to file Form NC-3 in the format prescribed by the Secretary.

Unless a payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed with the Department on or before January 31 for the preceding calendar year. During the calendar year, if a payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed on or before the last day of the month following the end of the calendar quarter in which the payer terminates its business, but no later than January 31 of the succeeding year. If a payer does not timely file Form NC-3 either electronically or by paper on or before the due date, the Secretary will impose a failure to timely file penalty against the payer as prescribed under G.S. § 105-236(a)(10)(c).

Important: A request to waive the failure to timely file an informational return penalty will affect a payer's good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department's Penalty Waiver Policy) allows every taxpayer one penalty waiver for most tax types every three years.

For additional details, see Reporting and Paying Tax Withheld.

Reference: G.S. § 105-163.3; G.S. § 105-163.7; G.S. § 105-236(a)(10); G.S. § 105-228.90; 17 NCAC 06C .0203.

2. Report to Income Recipients

Every payer who is required to or voluntarily withholds North Carolina income taxes from wages, nonwage compensation, or pension payments must furnish the recipient of the income a form or statement that reports the remuneration paid by the payer to the recipient during the calendar year, the total amount deducted and withheld from the remuneration, the payer's identification information, and the recipient's identification information. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if a payer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For additional details, see Reporting and Paying Tax Withheld.

Reference: G.S. § 105-163.3; G.S. § 105-163.7; G.S. § 105-236(a)(10); G.S. § 105-228.90; 17 NCAC 06C .0203.

f. Refund of Tax Withheld in Error

A payer who improperly withholds tax may refund the amount withheld in error to the payee if:

- The refund is made before the end of the calendar year.
- The refund is made before the payer furnishes the person the annual statement of tax withheld.

The payee must file an income tax return and claim credit for the tax withheld if the refund cannot be issued by the payer based on the above criteria. A payer who makes a refund of tax withheld to a payee should not report the amount refunded on the annual statement nor remit the amount refunded to the Department.

If the payer remits the amount of tax withheld in error to the Department, the payer may only refund the amount of tax withheld in error to the payee if the payer will pay additional compensation to the payee during the tax year. In that case, after refunding the amount withheld in error, the payer must reduce the next payment of tax withheld from compensation paid to the payee by the amount of that refund.

If the payer remits the amount of tax withheld in error to the Department and no additional compensation is due to be paid to the payee, the payer may not refund the tax withheld in error. The payee must file an income tax return and claim credit for the tax withheld.

Example 1. *A payer pays a payee $2,500 compensation in July 2026. The payer should have withheld $100 from the compensation ($2,500 x 4%); however, the payer withheld $250 from the compensation. The payer and payee do not discover the error until January 2026.*

Because the refund cannot be made before the end of the 2026 calendar year, the payer cannot refund the amount withheld in error to the payee. The payer must report the amount withheld on the annual statement to the payee and the payee must file an income tax return and claim credit for the tax withheld.

Example 2. *A payer pays a payee $5,000 compensation in May 2026. The payer should have withheld $200 from the compensation ($5,000 x 4%); however, the payer withheld $500 from the compensation. The payer discovers the error in June 2026 prior to remitting the $500 of withholding to the Department.*

The payer may refund $300 of tax withheld in error to the payee ($500 amount withheld - $200 correct withholding amount). The payer should remit $200 to the Department and the payer will show $200 withheld on the annual statement. The payer will not include the amount refunded on the annual statement.

Example 3. *A payer pays a payee $10,000 compensation in August 2026. The payer should have withheld $400 from the compensation ($10,000 x 4%); however, the payer* *withheld $1,000 from the compensation. The payer discovers the error in September 2026 after remitting the $1,000 of withholding to the Department. The payer will owe the ITIN contractor an additional $20,000 of compensation in October 2026.*

The payer may refund $600 of tax withheld in error to the payee. The payer will calculate withholding on the October 2026 compensation to the payee of $20,000 as follows:

Standard Calculation: $20,000 x 4% =	$800
Reduction for amount of refund remitted to Dept.	-$600
Withholding amount remitted to Dept.	$200

The payer will report the $1,200 of total withholding remitted on the annual statement ($1,000 remitted in August + $200 remitted in October). The amount is equal to four percent of the total compensation paid to the payee during the calendar year ($30,000 x 4%).

Example 4. *A payer pays a payee $6,000 compensation in November 2026. The payer should have withheld $240 from the compensation ($6,000 x 4%); however, the payer withheld $300 from the compensation. The payer discovers the error in December 2026 after remitting the $300 of withholding to the Department. The payer will not pay any additional compensation to the payee during 2026.*

The payer may not refund the amount of tax withheld in error to the payee. The payer must include the full amount of tax withheld and remitted to the Department on the annual statement ($300). The payee must file an income tax return and claim credit for the tax withheld.

g. Examples of Required Withholding from Compensation Paid to a Nonresident Contractor for Certain Services Performed in North Carolina

The following are examples of when State taxes should be withheld from compensation paid to a nonresident contractor for services performed in North Carolina:

Example 1. *A nightclub owner enters into a contract with a nonresident agent to provide entertainment at the owner's club. Compensation is paid directly to the agent.*

If the agent is an individual, tax is required to be withheld from the payment only to the extent the agent performed services in North Carolina. If the agent is a nonresident entity (LLC, partnership, corporation, etc.), tax must be withheld because the entity is deemed to be doing business in North Carolina through the entertainer. In either case, the agent is responsible for withholding 4% from the compensation paid to the entertainer because the entertainer is providing a personal service for the agent.

Example 2. *The same nightclub owner from Example 1 enters into a contract with a nonresident agent to locate an entertainer and also enters into a separate contract with the entertainer, who is a nonresident individual.*

The compensation paid to the agent is not subject to withholding unless the agent performs services in North Carolina. However, the club owner must withhold from the compensation paid to the entertainer.

Example 3. *A coliseum rents its facility to a resident promoter who has contracted with a nonresident performer for a concert at the coliseum. The coliseum deducts rent and other fees and expenses from the gross ticket proceeds before payment to the promoter. The promoter compensates the nonresident performer for the performance.*

No withholding is required from the ticket proceeds paid to the promoter because the promoter is a resident of North Carolina. The promoter is required to withhold the tax from the compensation paid to the nonresident performer because the performer is providing a personal service for the promoter.

5. Employee's Withholding Allowance Certificate

a. General

Each new employee, before beginning employment, shall give the employer a signed Form NC-4 or Form NC-4 EZ, North Carolina Employee's Withholding Allowance Certificate. An employee that is a nonresident alien employee shall provide a signed Form NC-4 NRA, Nonresident Alien Employee's Withholding Allowance Certificate, in lieu of Form NC-4 or Form NC-4 EZ.

The Department will allow an employer to establish a system for its employees to file North Carolina Employee's Withholding Allowance Certificates, Form NC-4, Form NC-4 EZ, or Form NC-4 NRA (if applicable), electronically if the employer is also using the system for federal form W-4s, Employee's Withholding Allowance Certificates. A certificate filed by a new employee is effective upon the first payment of wages after it is filed and remains in effect until the employee furnishes a new certificate unless the employee claimed total exemption from withholding during the prior year.

Employees claiming exemption from withholding must provide the employer a new Form NC-4 EZ by February 15 each year. State and federal definitions of single person, married, head of household, and surviving spouse are the same; however, the number of allowances to which an individual is entitled may differ. **Federal Withholding Certificates are not acceptable**. If an employee fails to furnish a withholding allowance certificate, Form NC-4 or Form NC-4 EZ, the employer must withhold tax as if the employee is single with no allowances.

The employer is not required to ascertain whether the total amount of allowances claimed is greater than the total number to which the employee is entitled. However, if the employer has reason to believe that the number of allowances claimed by an employee is greater than the number to which such employee is entitled, the employer must notify the Department at the time for filing the quarterly report for the quarter during which the certificate is received, if the employer files quarterly withholding reports. If the employer files monthly withholding reports, the employer shall notify the Department of certificates received during the quarter at the time for filing the monthly report for the third month of the quarter.

If an employee's allowances should decrease, requiring more tax to be withheld, the employee must provide an amended certificate to the employer within 10 days after the change. Should the allowances increase, requiring less tax to be withheld, the employee may provide an amended certificate to the employer at any time after the change occurs.

Reference: G.S. § 105-163.5; 17 NCAC 06C .0123; 17 NCAC 06C .0126.

b. Nonresident Alien Employee's Withholding Allowance Certificate, Form NC-4 NRA

Because nonresident aliens are generally not allowed a standard deduction, nonresident alien employees must complete and sign a North Carolina Nonresident Alien Employee's Withholding Allowance Certificate, Form NC-4 NRA. Nonresident alien employees must withhold tax using the "Single" filing status regardless of the employee's actual marital status. If an employee does not provide the employer with a completed NC-4 NRA, the employer must withhold as single with no allowances and withhold the additional tax as directed below.

In addition to claiming the proper number of allowances on line 1 of Form NC-4 NRA, a nonresident alien employee must complete line 2 to identify the amount of additional tax to be withheld from each pay period's wages. The additional amount per pay period is given in the tables contained in both Form NC-4 NRA and in Publication NC-30. Students and business apprentices who are residents of India and subject to the U.S.-India tax treaty may enter $0 on line 2.

Employers should limit the additional withholding to the lesser of the amount reported by the employee on line 2 or 4.09% of the wages for the period if the amount of wages for that period multiplied by the number of payroll periods during the year is less than the standard deduction for single filers. The Department provides a chart to assist employers with this calculation in Publication NC-30.

Reference: G.S. § 105-163.5; 17 NCAC 06C .0123; 17 NCAC 06C .0126.

6. Additional Withholding Allowances

Withholding allowances may be claimed by taxpayers expecting to have allowable itemized deductions exceeding the standard deduction or allowable adjustments to income. Additional allowances may be claimed for each $2,500 that the N.C. itemized deductions are expected to exceed the N.C. standard deduction and for each $2,500 of adjustments reducing income. Additional allowances may also be claimed if the taxpayer is entitled to a tax credit. The number of additional allowances is determined by dividing the amount of the tax credit by the product determined by multiplying the withholding tax rate by $2,500 and then rounding that number down to the nearest whole number. The withholding tax rate is the individual income tax rate plus one tenth of one percent (0.1%). For 2026, the individual income tax rate is 3.99%, so the withholding tax rate is 4.09%.

Reference: G.S. § 105-163.5; 17 NCAC 06C .0124.

7. Penalty for Unreasonable Allowance Certificate

G.S. § 105-163.5 provides a civil penalty against an employee who gives an employer an allowance certificate that contains information which has no reasonable basis and results in a lesser amount of tax being withheld than would have been withheld had the employee provided reasonable information. The penalty is 50% of the amount not properly withheld.

8. Submission of Certain Withholding Allowance Certificates

An employer is required to submit a copy of any withholding allowance certificate on which the employee claims more than 10 withholding allowances or claims exemption from withholding and the employee's wages per week would normally exceed an amount equal to the N.C. standard deduction for an individual with a filing status of single divided by 52. For tax year 2026, that amount is $245.

An employer filing a quarterly withholding report shall submit copies of the certificates received during the quarter when the quarterly report is filed. An employer filing monthly withholding reports shall submit copies of the certificates received during the quarter at the time for filing the monthly report for the third month of the calendar quarter.

Copies may be submitted earlier and for shorter reporting periods. Copies of the certificates, along with a letter showing the employer's name, address, withholding identification number, and the number of certificates submitted, should be mailed to the Department.

The employer shall withhold on the basis of the certificate until written notice is received from the Department that the certificate is defective. As part of that written notice, the Department will advise the employer to ignore the allowance certificate filed and to withhold using the number of allowances specified. The employer shall furnish the employee a copy of the written notice upon receipt.

If the employee files a new certificate, the employer must honor that certificate only if the employee does not claim exempt and claims a number smaller than the number allowed in the Department's written notice. If the new certificate claims a number larger than the employee has been allowed and the employee specifies, in writing, any circumstances as justification to support the claims, the employer must, upon receipt, forward a copy of the certificate and the employee's written statement to the Department for review. The employer must continue to withhold as specified in the Department's written notice until written notice is received from the Department advising the employer to withhold on the basis of the new certificate.

To increase withholding, an employee may claim less than the employee's allowable allowances or may enter into an agreement with the employer and request that an additional amount be withheld by entering the desired amount on NC-4, NC-4 EZ, or NC-4 NRA.

An employee working for two or more employers should claim the employee's allowable allowances with only one employer and claim zero allowances with the other employers.

Reference: 17 NCAC 06C .0126.

9. Employers

An employer is any person or organization for whom an individual performs any service as an employee or any person or organization that pays wages for any reason. The term includes federal, state, and local governmental agencies as well as religious, charitable, educational, and other nonprofit organizations even though they may be exempt for other tax purposes.

Note: Compliance with any of the provisions of North Carolina withholding by a nonresident employer will not be deemed to be evidence that the nonresident is doing business in this State. For more information, see G.S. § 105-163.4.

Reference: G.S. § 105-163.1.

10. Employees

a. General

For North Carolina income tax withholding purposes, an employee is either a resident individual legally domiciled in this State who performs services within or outside North Carolina for wages, or a nonresident of this State who performs services within the State for wages. For the purposes of this section, the location of the services performed by the employee is determined by the physical location at which the employee performs the services.

Example. *Employer is located in North Carolina and hires Employee A as a full-time remote teleworker. Employee A is a resident of Virginia. Employee A will perform all job duties in Virginia.*

Employer is not required to withhold North Carolina income tax from the wages of Employee A because Employee A is not a resident of North Carolina and Employee A will not perform services within North Carolina.

b. Tax Credits

To prevent double withholding and to anticipate any tax credits allowable to a North Carolina resident, withholding of North Carolina tax is not required from wages paid to a resident for services performed in another state if that state requires withholding. This relief from double withholding does not relieve the resident of the obligation to file a Form

D-400, North Carolina individual income tax return, and pay any balance due after receiving credit for taxes paid to the other state.

All wages received by a nonresident for services performed in this State are subject to withholding of North Carolina income tax. Any relief from double withholding must be granted by the nonresident's state of residence.

Example 1. *Employer is located in South Carolina and hires Employee A to work at Employer's location in South Carolina. Employee A is a resident of North Carolina and commutes to South Carolina each day to work.*

Employer is not required to withhold North Carolina income tax from the wages of Employee A. Even though Employee A is a resident of North Carolina, Employee A is performing all services that require withholding for Employer in South Carolina.

Example 2. *Employer is located in Georgia and hires Employee A as a full-time remote teleworker. Employee A is a resident of North Carolina. Employee A will perform all job duties entirely from Employee A's home in North Carolina.*

Employer is required to withhold North Carolina income tax from the wages of Employee because Employee is a resident of North Carolina and performs services for Employer in North Carolina.

For more information, see Credit for Income Tax Paid to Another State or Country.

Reference: G.S. § 105-163.1; 17 NCAC 06C .0107.

11. Employer-Employee Relationship

Everyone who performs services subject to the will and control of an employer, both as to what shall be done and how it shall be done, is an employee. An employer-employee relationship exists when the person for whom the services are performed has the right to control and direct the individual performing the services. Managers and other supervisory personnel, officers of corporations, and elected public officials are employees. Whether the employer actually controls and directs the manner in which the services are performed does not matter if the employer has the right to do so, and it does not matter that the employee is called by some other name such as partner, agent, or independent contractor; nor whether the individual works full or part time; nor how the payments are measured, paid, or what they are called.

Lawyers, physicians, contractors, and others who follow an independent trade, business, or profession in which they offer their services to the public, generally are not employees. If an individual is subject to the control and direction of another only as to the results of the individual's work and not as to the methods of accomplishing the results, the individual is generally an independent contractor and not an employee.

Reference: 17 NCAC 06C .0108.

12. Ministers

An ordained or licensed clergyman who performs services for a church of any religious denomination may file an election with the Secretary and the church he serves to be considered an employee of the church instead of self-employed. Until a clergyman files the election, amounts paid by a church to a clergyman are not subject to withholding.

Reference: G.S. § 105-163.1A.

13. Common Carrier

The Amtrak Reauthorization and Improvement Act of 1990 ("Act") provides that no part of the compensation paid to an employee of an interstate railroad subject to the jurisdiction of the Surface Transportation Board ("STB") may be subject to income tax, or income tax withholding, in any state except the state of the employee's residence when such employee performs regular assigned duties in more than one state. The Act also precludes the taxation of compensation paid by an interstate motor carrier subject to the jurisdiction of the STB or to an employee of a private motor carrier performing services in two or more states except by the state of the employee's residence. Therefore, compensation received by such nonresident employee for services performed in this State will not be subject to North Carolina income tax or income tax withholding.

Under the Federal Aviation Act (49 U.S.C. § 40116), a nonresident airline employee rendering services on an aircraft would not be liable for North Carolina income tax unless the scheduled flight time in North Carolina is more than 50% of the total scheduled flight time during the calendar year. If the employee's flight logs show that more than 50% of the scheduled flight time is in North Carolina, the amount of income reportable to North Carolina would be based on the percentage that the North Carolina flight time is to the total flight time for the year.

14. Federal Employees

Under an agreement with North Carolina, federal agencies withhold North Carolina income tax from the military pay of members of the Armed Forces designated as legal residents of North Carolina, and from the pay of civilian federal employees whose regular place of employment is in North Carolina.

15. Military Spouse

Under the Servicemembers Civil Relief Act, the wages of a spouse of a military servicemember who is legally domiciled in a state other than North Carolina are exempt from North Carolina income tax if the spouse meets all the following conditions:

a. The servicemember is present in North Carolina solely in compliance with military orders; and

b. The spouse is in North Carolina solely to be with the servicemember.

The Veterans Auto and Education Improvement Act of 2022 ("VAEIA") authorizes a servicemember and spouse to elect to use any of the following as the state of domicile for income tax purposes:

1. The residence or domicile state of the servicemember.
2. The residence or domicile state of the spouse.
3. The permanent duty station of the servicemember.

Therefore, if a military spouse is not domiciled in North Carolina and meets the exemption conditions of VAEIA, an employer is not required to withhold North Carolina income tax from wages paid to the military spouse. The military spouse must furnish to the employer Form NC-4 EZ, North Carolina Employee's Withholding Allowance Certificate, certifying that the spouse is not subject to North Carolina withholding because the conditions for exemption under VAEIA have been met. The military spouse must certify the state of domicile and attach a copy of the spousal military identification card and a copy of the servicemember's most recent leave and earnings statement to Form NC-4 EZ.

The VAEIA does not exempt a military spouse who is domiciled in North Carolina from North Carolina withholding tax. Withholding from wages paid to a military spouse domiciled in North Carolina is still required.

16. Seamen

The Vessel Worker Tax Fairness Act, 46 U.S.C. § 11108, prohibits withholding of state income tax from the wages of a seaman on a vessel engaged in foreign, coastwise, intercoastal, interstate, or noncontiguous trade, or an individual employed on a fishing vessel or any fish processing vessel. Vessels engaged in other activity do not fall under the restriction; however, any seaman who is employed in coastwise trade between ports in North Carolina may have tax withheld if such withholding is pursuant to a voluntary agreement between such seaman and his employer.

With respect to income obtained while: (1) engaged as a pilot (licensed under section 7101 of Title 46 of the Code or under the laws of a state) on a vessel performing duties in more than one state; or (2) performing regularly assigned duties as a master, officer or crewman on a vessel operating on the navigable waters of more than one state, an individual is subject to income tax only in the state and political subdivision in which the individual resides.

Seamen and fishing boat crewmen exempt from withholding must determine whether they meet the requirements for making payments of estimated income tax.

Reference: 17 NCAC 06C .0112.

17. Professional Athlete

Professional athletic teams must withhold income tax from the North Carolina source income of a nonresident member of the team at the rate for individuals with no withholding allowances.

(See Tax Rates for a schedule of North Carolina tax rates.) Taxes shall be withheld from the income of a resident member of the team in the same manner as taxes are withheld from other residents.

Professional athletic teams not domiciled in North Carolina are classified as quarterly employers and must file returns reporting the amount of taxes withheld and pay the amounts withheld on a quarterly basis.

Professional athletic teams that are domiciled in North Carolina must determine their filing and paying requirements in the same manner as all employers domiciled in North Carolina.

A nonresident member of a professional athletic team is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the compensation received for services rendered as a member of the professional team and the professional team has met the withholding requirements of this section. The individual may file an individual income tax return and claim the tax withheld on their behalf.

The professional athletic team, as well as the individual, is personally and individually liable for any additional income tax due if the professional athletic team does not properly determine the individual's North Carolina source income or properly withhold tax from that income. The Department will not collect the additional tax, penalty, or interest due twice.

Reference: 17 NCAC 06B .3905.

18. Domestic/Household Employee

An employer is not required to withhold North Carolina income tax from the wages of domestic/household employee; however, the employer and employee may enter into a voluntary agreement to withhold North Carolina income tax from the employee's wages. The amount to withhold is based on the employee information shown on Form NC-4 or Form NC-4 EZ, North Carolina Employee's Withholding Allowance Certificate. An employer may wish to contact the Division of Employment Security regarding any employment insurance liability.

19. Farm Labor

Compensation paid by a farmer for services performed on the farmer's farm in producing or harvesting agricultural products or in transporting the agricultural products to market is subject to North Carolina withholding.

Wages paid to agricultural workers are subject to North Carolina withholding to the same extent federal income tax withholding is required. Generally, wages paid to agricultural workers are subject to federal income tax withholding if the worker is paid $150 or more during the year or the employer pays $2,500 or more to all agricultural workers during the year.

Compensation paid to agricultural workers who are ITIN holders is also subject to North Carolina withholding. For more information, refer to Withholding from Nonwage

Compensation. **Note:** An exception exists for aliens commonly referred to as H-2A agricultural workers.

20. North Carolina State Lottery Winnings

Winnings of $600 or more paid by the North Carolina State Lottery Commission are subject to State withholding at the rate 3.99% for tax year 2026.

Reference: G.S. § 105-163.2B.

21. Supplemental Wage

If an employer pays a supplemental wage separately (or combines the supplemental wage with regular wages in a single payment and specifies the amount of each), the income tax withholding method depends on whether the employer withholds North Carolina income tax from the employee's regular wage and whether the regular wage and supplemental wage is paid in a single payment. If the employer withholds North Carolina income tax from an employee's regular wage, the employer can use one of the following methods for the supplemental wage:

a. Withhold a flat 4.09% for tax year 2026, or
b. Add the supplemental wage and the regular wage for the most recent payroll period and figure the North Carolina income tax together, as if the total wages were a single payment. Subtract the North Carolina income tax previously withheld from the regular wage and withhold the remaining North Carolina income tax from the supplemental wage. **Note:** If the employer does not withhold income tax from the employee's regular wage, the employer must use "method b."

Vacation Pay Treated as Supplemental Wage. Vacation pay is subject to North Carolina withholding as if it were a regular wage payment. If vacation pay is paid in addition to the regular wage, the employer should treat the vacation pay as a supplemental wage. If vacation pay is for a time longer than an employer's usual payroll period, the employer must spread the vacation pay over the pay periods for which it is paid.

Tips Treated as Supplemental Wage. The employer must withhold North Carolina income tax on tips from wages or collect North Carolina income tax from the employee based on the amount of tips received. If an employee receives a regular wage and reports tips to the employer, the employer must calculate North Carolina income tax as if the tips were a supplemental wage. If the employer has not withheld North Carolina income tax from the employee's regular wage, the employer must add the tips to the regular wage and withhold North Carolina income tax on the total. If the employer withheld North Carolina income tax from the employee's regular wage, the employer can subtract the North Carolina income tax previously withheld from the regular wage and withhold the remaining North Carolina income tax from tips.

Reference: 17 NCAC 06C .0117.

22. Wage and Tax Statement

An employer should use federal Form W-2 or an alternate wage and tax statement that provides the same information as the federal Form W-2. The wage and tax statement must show the employer's North Carolina withholding identification number, designate the state tax as North Carolina income tax, and report the employee's North Carolina gross wage separately from the employee's federal gross wage.

Reference: 17 NCAC 06C .0119.

23. Reciprocity of Tax Credits

North Carolina does not allow an income tax credit for taxes paid to another state to a nonresident; therefore, any relief from double taxation must be granted by the state of residence. North Carolina provides such relief to its residents.

Reference: 17 NCAC 06C .0120.

24. Credit for Income Tax Withheld

G.S. § 105-163.10 provides that the amount deducted and withheld during any calendar year from the compensation of any individual must be allowed as a credit to that individual against the tax imposed under G.S. § 105-153.7 for taxable years beginning in such calendar year. For example, a taxpayer filing his return for a fiscal year ending September 30, 2026, will be allowed credit for tax withheld from wages for the calendar year ending December 31, 2026. This is the case even though the taxpayer must report the income on the return for the fiscal year ending September 30, 2026.

XI. Reporting and Paying Tax Withheld

1. New Withholding Agents, including Employers, Pension Payers, and Other Payers

Each new withholding agent who is required to or voluntarily withholds North Carolina income tax must register on the Department's website or complete and file Form NC-BR, Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Other Taxes and Service Charge. The Department will assign a State withholding identification number which should be used on all reports, returns, and correspondence concerning withholding. Do not use the number of another taxpayer from whom a business was acquired.

Reference: 17 NCAC 06C .0201.

2. Reports and Payments

North Carolina income tax withheld is paid quarterly, monthly, or semiweekly. Taxpayers who withhold an average of less than $250 from wages, nonwage compensation, and pensions each month must file a quarterly return and pay the withheld taxes on a quarterly basis. The quarterly return and payment are due by the last day of the month following the end of the calendar quarter.

Taxpayers who withhold an average of at least $250 but less than $2,000 from wages, nonwage compensation, and pensions each month must file a monthly return and pay the withheld taxes on a monthly basis. All monthly returns and payments are due by the fifteenth day of the month following the month in which the tax was withheld; except the return and payment for the month of December are due to be filed on or before January 31.

Taxpayers who withhold an average of at least $2,000 from wages, nonwage compensation, and pensions each month must file a report and pay the withheld taxes at the same time they are required to file reports and pay the tax withheld on the same wages, nonwage compensation, and pensions for federal income tax purposes. The due dates for reporting and paying North Carolina income tax withheld are determined by the due dates for depositing federal employment taxes (income tax withheld and FICA). Each time a taxpayer is required to deposit federal employment taxes, the taxpayer must remit the North Carolina income tax withheld on those same wages, nonwage compensation, and pensions, regardless of the amount of State tax withheld.

Exception. For federal income tax purposes, if a taxpayer withholds $100,000 or more, the deposit is required on the next banking day. North Carolina did not adopt this provision of federal law, and the State income tax withholding on the same wages, nonwage compensation, and pensions is due on or before the normal federal semiweekly due date for those wages, nonwage compensation, and pensions. The taxpayer must mail or deliver payment of the North Carolina income tax withheld by the due date.

Semiweekly filers are required to reconcile the tax paid with the tax withheld for the quarter on Form NC-5Q, Quarterly Income Tax Withholding Return. The due dates for Form NC-5Q are the same as for the federal quarterly return (federal Form 941). A taxpayer has 10 additional days to file the return if all required payments were made during the quarter and no additional tax is due. A taxpayer reconciles the tax paid and the tax withheld for the year by filing Form NC-3, Annual Withholding Reconciliation. Form NC-3 is due to be filed on or before January 31 following the end of the tax year. If a taxpayer terminates its business, the taxpayer must file Form NC-3 on or before the last day of the month following the end of the calendar quarter in which the taxpayer terminates its business, but no later than January 31 of the succeeding year. For information on when a document is considered timely filed, see Departmental Directive TA-16-1 and Departmental Directive TA-18-1.

Reference: G.S. § 105-163.6.

3. eServices

Taxpayers can file their North Carolina withholding returns and pay their taxes online using the Department's eServices. Payments can be made by bank draft (no convenience fee) or credit or debit card using Visa or MasterCard (convenience fee). **Note:** A taxpayer that remits an average of $20,000 each month in North Carolina withholding tax is required to pay the tax by electronic funds transfer.

Reference: G.S. § 105-241(b)(3).

4. Amount Withheld in Trust for the Secretary of Revenue

a. General

Any amount of North Carolina income tax withheld by a taxpayer is deemed to be held in trust for the Secretary of Revenue.

A penalty of 5% of the amount due is imposed for failure to withhold or to pay the tax when due. The penalty for failure to timely file a withholding return is 5% of the tax due per month (maximum 25%). In addition, criminal penalties are provided for willful failure to comply with the withholding statutes.

A taxpayer who fails to withhold or pay the amount required to be withheld is personally and individually liable for the tax, including any penalties and interest due. If a taxpayer fails to file a return and pay the tax due or files a grossly incorrect or false or fraudulent return, the Secretary must estimate the tax due and assess the taxpayer based on the estimate.

When the Department determines that collection of the tax is in jeopardy, a taxpayer may be required to report and pay the tax at any time after payment of the wages, nonwage compensation, and pensions.

b. Responsible Person Assessments

If a taxpayer has fails to withhold the proper amount of North Carolina income tax or fails to remit the amount of North Carolina income tax withheld, the unpaid principal amount of North Carolina income tax may be assessed against the responsible person of the taxpayer. The term "responsible person" means the president, treasurer, or chief financial officer of a corporation; a manager of a limited liability company or a partnership; any officer of a corporation, a member or company official of a limited liability company, or a partner in a partnership who has a duty to deduct, account for, or pay over income tax withheld or required to be withheld; or a partner who is liable for the debts and obligations of a partnership under G.S. § 59-45 or G.S. § 59-403.

More than one person may be liable as a person responsible for the payment of North Carolina withholding tax; however, the amount of the North Carolina income tax withheld or required to have been withheld can be collected only once, whether from the taxpayer or one or more responsible persons. It is not necessary that the failure to collect and pay North Carolina withholding tax was willful; it is only necessary that the responsible person failed to pay the North Carolina tax withheld or required to have been withheld to the Secretary of Revenue.

Reference: G.S. § 105-163.8; 17 NCAC 06C .0204; G.S. § 105-242.2.

5. Annual Report

a. Informational Returns

1. Form NC-3

An employer or other payer that is required to or voluntarily withholds North Carolina income tax must electronically file Form NC-3, Annual Withholding Reconciliation, with the Department. As part of the Form NC-3 filing requirement, certain forms or statements, collectively, "Forms," must also be electronically filed. Refer to the chart below to determine whether a specific Form must be filed.

Important: If any Form listed on the following chart reports North Carolina income tax withheld, the Form must be filed with the Department regardless of whether the Form meets the Internal Revenue Service threshold for filing the Form with the IRS.

Form	Required to file if NC withholding reported?	Required to file if <u>no</u> NC withholding reported and Form meets IRS Filing Threshold?
W-2	Yes	Yes, if issued to NC resident or issued to nonresident for services performed in NC
W-2G	Yes	No, if reported to the IRS
1099-MISC	Yes	No
1099-NEC	Yes	No
1099-R	Yes	Yes, if recipient's address is located in NC
1099-B	Yes	No, if reported to the IRS
1099-DIV	Yes	No, if reported to the IRS
1099-INT	Yes	No, if reported to the IRS
1099-OID	Yes	No, if reported to the IRS
1099-G	Yes	No, if reported to the IRS
1042-S	Yes	Yes, if it includes NC source income
NC-1099M	Yes	No, if reported to the IRS on Form 1099-NEC or Form 1099-MISC

If an employer or other payer terminates its business in 2026, the employer or other payer should follow the guidance provided for 2025 Form NC-3 and required W-2 and 1099 statements.

Note: Nonwage compensation must be reported on North Carolina Form NC-1099M, Compensation Paid to a Payee. If an employer or other payer is required to complete a federal Form 1099-MISC or federal Form 1099-NEC to report nonwage compensation paid to a payee, the employer or other payer is not required to complete Form NC-1099M. For additional details about withholding from compensation paid to a payee, see Withholding from Nonwage Compensation.

2. Due Date

Form NC-3 and the required W-2, 1099, and 1042-S statements (collectively "Form NC-3") must be filed on or before January 31 of the following calendar year and in an electronic format as prescribed by the Secretary. If an employer or other payer terminates its business, Form NC-3 and the required W-2 and 1099 statements must be filed on or before the last day of the month following the end of the calendar quarter in which the employer terminates its business, but no later than January 31 of the succeeding year.

3. Informational Return Penalty

The penalty for failure to timely file an informational return by the due date of the return is $50 per day, up to a maximum of $1,000. A request to waive the failure to timely file an informational return penalty affects a payer's good compliance record for purposes of withholding tax. The good compliance reason (as described in the Department's Penalty Waiver Policy) allows every taxpayer one penalty waiver for most tax types every three years. The penalty for failure to file the informational return in the format prescribed by the Secretary is $200. For purposes of Form NC-3, the format prescribed by the Secretary requires Form NC-3 and the State's copy of required W-2 and 1099 statements to be filed electronically on or before the due date via the eNC3 and Information Reporting Application located on the Department's website.

Note: If Form NC-3 is not filed in the format prescribed by the Secretary, the Department will assess the $200 penalty against an employer or other payer as prescribed under G.S. § 105-236(a)(10)(d) for failure to file Form NC-3 in the format prescribed by the Secretary.

For additional information on the eNC3 and Information Reporting Application including step-by-step guidelines on how to use the eNC3 and Information Reporting Application, see the eNC3 webpage located on the Department's website. The eNC3 webpage includes additional information such as frequently asked questions and examples of when an employer or other payer may be subject to the informational return penalties.

Reference: G.S. § 105-236(a)(10).

4. Other Informational Returns

A person who is a resident of North Carolina, has a place of business in North Carolina, or has an employee, agent, or another representative in any capacity in North Carolina, is required to file an informational return with the Secretary if the person directly or indirectly pays or controls the payment of any North Carolina income to a taxpayer. The informational return must contain all the information required by the Secretary. Refer to the following chart to determine whether a specific informational return or statement (collectively, a "Form") must be filed with the Secretary.

Important: A person that is not required to file Form NC-3 should not apply for a withholding number with the Secretary and should not file a Form NC-3. Instead, the required Forms should be reported to the Secretary via the eNC3 and Information Reporting Application. For additional information on the eNC3 and Information Reporting Application, see the eNC3 webpage located on the Department's website.

Form	Filing Requirement if Form Meets IRS Filing Threshold
W-2	Yes, if issued to NC resident or issued to nonresident for services performed in NC
W-2G	No, if reported to the IRS
1099-MISC	No
1099-NEC	No
1099-R	Yes, if recipient's address is located in NC
1099-B	No, if reported to the IRS
1099-DIV	No, if reported to the IRS
1099-INT	No, if reported to the IRS
1099-OID	No, if reported to the IRS
1099-G	No, if reported to the IRS
1042-S	Yes, if it includes NC source income
NC-1099M	No, if reported to the IRS on federal Form 1099-MISC or 1099-NEC

Note: A person that is not required to file Form NC-3 but is required to file a Form listed above is not subject to the informational return penalties prescribed in G.S. § 105-236(a)(10).

Reference: G.S. § 105-154; G.S. § 105-163.1; G.S. § 105-163.2A; G.S. § 105-163.2B; G.S. § 105-163.3; G.S. § 105-163.7, 17 NCAC 06C .0203.

b. Report to Employee, Contractor, Pension Payment Recipient, or Other Income Recipient

Every employer and other payer who is required to or voluntarily withholds North Carolina income taxes from wages, nonwage compensation, or pension payments must furnish the recipient of the income a form or statement that reports certain information required by North Carolina law. In general, these forms and statements must be provided to the recipients on or before January 31 of the following calendar year. However, if an employer or other payer terminates its relationship with an employee, a contractor, or a pension payment recipient before the close of the calendar year, they must provide the forms or statements to the recipients within 30 days of the last payment.

For purposes of this filing requirement, a person is required to report the following information to the recipient of the income:

1. **Report to Employee:** Employers must furnish two copies of the wage and tax statements, Form W-2, to employees from whom North Carolina income tax was withheld. The Internal Revenue Service supplies a six-part Form W-2, which will produce the required federal, and North Carolina statements in one packet.

2. **Report to Payee:** A payer is required to withhold North Carolina income tax of four percent (4%) from nonwage compensation paid to a payee. For the definition of the term "payee" and other details, see Withholding from Nonwage Compensation.

   A payer who withholds North Carolina income tax from compensation paid to a payee must provide the payee a statement showing the total compensation paid and the amount of North Carolina income tax withheld during the calendar year. The payer must give Form NC-1099M, Compensation Paid to a Payee, to the payee. Federal Form 1099-MISC or Form 1099-NEC may be provided in lieu of Form NC-1099M.

3. **Report to Pension Payment Recipient:** A payer who withholds North Carolina income tax from pension income must give the recipient federal Form 1099-R, showing the pension amount paid and the North Carolina income tax withheld.

4. **Report to Other Income Recipients:** A payer who withholds North Carolina income tax from any other income recipients must provide the recipients with the appropriate form or statement that reports identifying information of the payer and recipient, total amount of income payments, and the amount of North Carolina income tax withheld from the income payments.

Reference: G.S. § 105-163.1; G.S. § 105-163.2A*;* G.S. § 105-163.2B; G.S. § 105-163.3; G.S. § 105-163.7; G.S. § 105-228.90.

XII. Statute of Limitations

1. General

Article 9 of Chapter 105 of the North Carolina General Statutes contain certain time limitations, generally referred to as the "statute of limitations."

An income tax return from which information required to calculate the taxpayer's income tax liability has been omitted is not a tax return for the purpose of determining the applicable statute of limitations. The date a properly filed income tax return is filed is the determining date for purposes of the statute of limitations.

Reference: 17 NCAC 06B .3402; G.S. § 105-241.6; G.S. § 105-241.8.

2. Statute of Limitations for Refunds

a. General. The general statute of limitations for obtaining a refund of an overpayment applies unless a different period applies as provided under G.S. § 105-241.6(b). The general statute of limitations for obtaining a refund of an overpayment is the later of the following:

1. Three years after the due date of the return.
2. Two years after payment of the tax. The amount of a refund authorized under G.S. § 105-241.6(a)(2) cannot exceed the portion of the tax paid during the two years immediately preceding the taxpayer's request for refund.

b. Exceptions. The exceptions to the general statute of limitations for obtaining a refund of an overpayment are as follows:

1. **Federal Determination**. If a taxpayer files a timely tax return reflecting a federal determination, and the tax return is filed within the time period required under State law, 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.

2. **Waiver.** A taxpayer's waiver of the statute of limitations for making a proposed assessment extends the period in which the taxpayer can obtain a refund to the end of the period extended by the waiver.

3. **Worthless Debts or Securities.** For overpayments attributable to worthless debts or securities, the period of time for demanding a refund is seven years as determined under section 6511(d)(1) of the Code.

4. **Capital Loss and Net Operating Loss Carrybacks.** For overpayments attributable to capital loss and net operating loss carrybacks, the period of time for demanding a refund is three years from the due date of the return for the year in which the loss was incurred

rather than three years from the due date of the return for the year to which the loss is carried back as determined under section 6511(d)(2) of the Code.

5. **Contingent Event.** Overpayments attributable to a contingent event. G.S. § 105-241.6(b)(5) provides an exception to the general statute of limitations for obtaining a refund of an overpayment due to a contingent event. The statute addresses the following types of contingent events whereby the general statute of limitations for refunds may be extended once:

   a. **Litigation or State Tax Audit**. If a taxpayer is subject to litigation or a state tax audit that prevents the taxpayer from filing an accurate and definite request for a refund of an overpayment within the period under G.S. § 105-241.6, the period to request a refund of an overpayment is six months after the litigation or state tax audit concludes. The taxpayer must file written notice to the Secretary prior to expiration of the statute of limitations under G.S. § 105-241.6. The notice must identify and describe the litigation or state tax audit, identify the type of tax, list the return or payment affected, and state in clear terms the basis for and an estimated amount of the overpayment.

   b. **Other Events**. If a taxpayer contends that an event, other than litigation or a state tax audit, has occurred that prevents the taxpayer from filing an accurate and definite request for a refund of an overpayment within the period under G.S. § 105-241.6, the taxpayer may submit a written request to the Secretary seeking an extension of the statute of limitations. The taxpayer must file a written request to the Secretary prior to expiration of the statute of limitations under G.S. § 105-241.6. The request must establish by clear, convincing proof that the event is beyond the taxpayer's control and prevents the taxpayer from timely filing an accurate and definite request for a refund of an overpayment. The Secretary's decision on the request is final and is not subject to administrative or judicial review. If the Secretary agrees to the request, the period to file a request for a refund of an overpayment is six months after the event concludes.

   For more information, see Exception to the General Statute of Limitations for Certain Events.

Reference: G.S. § 105-241.6.

3. Statute of Limitations for Assessments

a. **General**. The general statute of limitations for proposing an assessment applies unless a different period applies unless a different period applies under G.S. § 105-241.8(b). The general statute of limitations for proposing an assessment is the later of the following:

   1. Three years after the due date of the return.
   2. Three years after the return was filed, whichever is later.

b. Exceptions. The exceptions to the general statute of limitations for proposing an assessment are as follows:

1. **Federal Determination** If a taxpayer files a timely return reflecting a federal determination, the period of time 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 there is a federal determination and a timely return is not filed, the period of time for proposing an assessment is three years after the date the Department received the final report of the federal determination.

2. **Federal Amended Return.** If a taxpayer amends a North Carolina tax return as a result of filing a federal amended return and the return is filed within the time required under 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 taxpayer does not amend a North Carolina tax return within the required time period, 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. The date the federal amended return was filed is presumed to be the date recorded by the Internal Revenue Service. For more information on filing amended tax returns, see Amended Returns.

3. **Failure to File or Filing a False Return.** If a taxpayer did not file a return, filed a fraudulent return, or attempted to fraudulently evade or defeat the tax, there is no statute of limitations, and an assessment may be proposed at any time.

4. **Failure to Pay Trust Taxes.** If a taxpayer, as a trustee, collects taxes on behalf of North Carolina, but fails to remit all the taxes held in trust when due, the period for proposing an assessment is the later of:

   a. Ten years after the due date of the return.
   b. Ten years after the taxpayer filed the return.

5. **Tax Forfeiture.** If a taxpayer forfeits a tax credit or tax benefit, the period of time for proposing an assessment of any tax due resulting from the forfeiture is three years after the date of the forfeiture.

Note: There is no provision in Chapter 105 that prohibit the Department for proposing an assessment for a given year after an assessment has already been proposed for the same tax year. Subsequent assessments can be made upon the discovery of new facts provided the assessment is proposed with the statute of limitations for assessments.

Reference: G.S. § 105-241.8.

4. Servicemembers in Combat Zones

An individual who is serving in the Armed Forces, or who is serving in support of the Armed Forces, in an area designated by the President as a combat zone, and who receives an extension of time to file a federal income tax return and receives relief from the accrual of penalty and interest as a result of serving in a combat zone or for being hospitalized as a result of wounds, disease, or injury sustained while serving in a combat zone, will receive the same extension of time for filing and the same relief from the accrual of penalty and interest for State income tax purposes.

In general, the following process is used to calculate the extended combat zone due date. First, determine the number of days left in the filing period when the taxpayer entered the combat zone. To determine the length of the extension period, the taxpayer adds 180 to this number. The extension period begins once the taxpayer returns from the combat zone. **Note:** If a taxpayer enters a combat zone after the due date for a filing period, the due date is not extended.

Example 1. *Taxpayer seeks to determine the extended due date for the 2024 North Carolina individual income tax return. Taxpayer enters a combat zone on March 1, 2025. Taxpayer exits the combat zone on December 1, 2025.*

When taxpayer entered the combat zone, there were 45 days remaining in the filing period. Adding 45 to 180, the taxpayer will receive a total extension of 225 days after returning from the combat zone. Since the taxpayer returned from the combat zone on December 1, 2025, the 225 days extension extends the due date for the 2023 return until July 14, 2026.

Example 2. *Taxpayer seeks to determine the extended due date for the 2024 North Carolina individual income tax return. Taxpayer enters a combat zone on November 1, 2025.*

Because taxpayer did not enter the combat zone until after the due date for the 2024 return, the due date is not extended.

The compensation of a military or civilian employee of the United States who dies because of terroristic or military action is exempt from State income tax for the same periods for which the income is exempt for federal income tax purposes.

Reference: G.S. § 105-249.2(a)

5. Waiver of Time Limitation

A taxpayer may make a written waiver of the limitations of time specified by law for assessing any tax or additional tax, for either a definite or indefinite period of time, and if such waiver is accepted, the Secretary of Revenue may propose an assessment at any time within the extended period. An agreement by a taxpayer to extend the time in which the Secretary of Revenue can assess the taxpayer automatically extends the period of time for refunds of overpayments by the taxpayer.

Reference: 17 NCAC 01C .0307.

6. Due Dates on Saturday, Sunday, or Legal Holiday

The Department will consider a tax return or tax payment (collectively, a "Document") as timely filed if the Document is filed with the Department on the next business day after a weekend or legal holiday. **Note:** The Department will consider the Document to be timely filed only if the Document was received by the Department. Moreover, the statutory due date of a Document received on a Saturday, Sunday, or legal holiday does not change.

Example: In 2023, April 15 fell on a Saturday and Emancipation Day, a legal holiday in the District of Columbia, was observed on Monday, April 17, 2023. If a taxpayer filed a 2022 North Carolina individual income tax return on or before April 18, 2023, (and the Department received the income tax return), the tax return was considered timely filed. Presuming that there are no subsequent payments of tax, the taxpayer has until **April 15, 2026**, three years from the statutory due date of the tax return, to request a refund of an overpayment pursuant to the general statute of limitations for refunds.

Reference: G.S. § 105-155, G.S. § 105-263; Departmental Directive TA-16-1; Departmental Directive TA-18-1.

XIII. Federal Determinations

1. General

A federal determination is defined as a change or correction arising from an audit by the Commissioner of Internal Revenue or an agreement of the U.S. competent authority, and the change or correction has become final. A federal determination is final when the determination is not subject to administrative or judicial review. In addition, audit findings are deemed final when (1) the taxpayer receives audit findings from the IRS for the tax period and the taxpayer does not timely file an administrative appeal with the IRS, or (2) the taxpayer consents to any of the audit findings for the tax period through a form or other written agreement with the IRS.

If a taxpayer's federal adjusted gross income, filing status, personal exemptions, standard deduction, itemized deductions, or federal tax credit are changed or corrected by the Internal Revenue Service or 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.

Reference: G.S. § 105-159; G.S. § 105-241.6(b)(1); G.S. § 105-241.7; G.S. § 105-241.8(b)(1); G.S. § 105-241.10; G.S. § 105-228.90(b)(15).

2. Refunds and Assessments after a Federal Determination

a. When a taxpayer timely files a return reflecting a federal determination

When a taxpayer timely files a return reflecting a federal determination that affects the amount of State tax payable and the general statute of limitations for requesting a refund or proposing an assessment of the State tax has expired, the taxpayer is entitled to a refund or is liable for additional tax only if the refund or additional tax is the result of adjustments related to the federal determination.

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.

b. When a taxpayer does not timely file a return reflecting a federal determination

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).

The period for proposing an assessment of any tax due is three years after the date the Secretary receives the final report of the federal determination. 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.

Reference: G.S. § 105-159; G.S. § 105-241.6(b)(1); G.S. § 105-241.7; G.S. § 105-241.8(b)(1); G.S. § 105-241.10; G.S. § 105-228.90(b)(3a).

3. Federal Determinations and Fraud

When there is a federal determination and a fraud penalty is assessed by the federal government, the State may open the tax year on the basis of either fraud or the federal determination. If a North Carolina income tax return has not been filed, the 50% fraud penalty and the 5% per month (25% maximum) failure to file penalty may be assessed.

Reference: G.S. § 105-236(a)(3); G.S. § 105-236(a)(6); 17 NCAC 06B .3206; 17 NCAC 06B .3404.

XIV. Appeals Process & Collection of Tax

1. General

Taxpayers who disagree with a proposed assessment of tax or a denial of a refund may request a Departmental review of the Department's action by submitting Form NC-242, Objection and Request for Departmental Review, to the Department. The request for review must be filed with the Department within 45 days from the date the notice was (1) mailed to the taxpayer, or (2) delivered in person to the taxpayer. **Note:** The request for review can be filed at any time between the date that the inaction by the Department on a request for refund is considered a proposed denial of the refund and the date the time periods set in G.S. 105-241.11(a) expires. For more information, see Resolving Disputes about Your Taxes.

Important: An assessment for taxes shown due on a tax return but not paid or the application of refunds to debts owed to North Carolina and local government agencies or the Internal Revenue Service is not subject to the review process.

Reference: G.S. § 105-241.11; G.S. § 105-241.22(1); Chapter105A.

2. Denial of Refund Based on Statute of Limitations

If the Department denies a refund based on the Department's determination that the request for refund was filed outside of the statute of limitations for refunds, the Department must deny the refund request and sent the taxpayer a notice of denial. The taxpayer may contest the Department's determination by filing a petition for a contested tax case hearing at the Office of Administrative Hearings in accordance with Article 3 of Chapter 150B of the General Statutes. The petition must be filed within sixty (60) days of the date of the notice of denial. The sole issue to be decided by the administrative law judge is whether the statute of limitations bars the taxpayer's claim for refund of an overpayment. The final decision by the administrative law judge regarding the statute of limitations is subject to judicial review under Article 4 of Chapter 150B and under G.S. § 105-241.16.

After judicial review, if the final decision is that the taxpayer's claim for refund is not barred by the statute of limitations, then the taxpayer's claim for refund is remanded to the Department for review of the substantive issues. Any remand is regarded as a new amended return or claim for refund timely filed within the statute of limitations under G.S. § 105-241.7(c). For more information, see the Department's Important Notice dated July 13, 2016.

Reference: G.S. § 105-241.7(c1); G.S. § 105-241.15(b).

3. Collection of Tax

The Department may collect a tax in the following circumstances:

a. When a taxpayer files a return showing an amount due with the return and does not pay the amount shown due.

b. When the Department sends a notice of collection after a taxpayer does not file a timely request for a Departmental review of a proposed assessment of tax or based upon taxpayer inaction after timely filing a request for review in accordance with G.S. § 105-241.13A.

c. When a taxpayer and the Department agree on a settlement concerning the amount of tax due.

d. When the Department sends a notice of final determination concerning an assessment of tax and the taxpayer does not file a timely petition for a contested case hearing on the assessment.

e. When a final decision is issued on a proposed assessment of tax after a contested case hearing.

f. When the Office of Administrative Hearings dismisses a petition for a contested case for lack of jurisdiction because the sole issue is the constitutionality of a statute and not the application of a statute.

Reference: G.S. § 105-241.22.

4. Servicemembers Civil Relief Act

Certain sections of the Servicemembers Civil Relief Act ("Act") are pertinent to matters of federal and state taxation. With respect to payment of income tax, the Act provides for the deferment of payment of income tax for a period of 180 days after military service ends if the servicemember's inability to pay the income tax was caused by military service. No penalty or interest shall accrue during the period of deferment.

Reference: Servicemembers Civil Relief Act.

XV. Penalties and Interest

1. General

The North Carolina General Statutes provide both civil and criminal penalties for failure to comply with the income tax laws. The more common penalties are included below. For additional information, see G.S. § 105-236. In addition to any applicable penalty, all assessments of taxes or additional taxes bear interest at the applicable rate from the due date until date of payment.

Reference: G.S. § 105-236; G.S. § 105-249.2(b).

2. Failure to File and Failure to Pay Penalties

Both the late filing penalty and the late payment penalty can be applied for the same month. If the tax return is filed late with net tax due, both the late filing and late payment penalties will be assessed at the same time. "Net tax due" is the amount of tax required to be shown on the return less any timely payments of the tax and allowable credits.

A tax return filed after the due date is subject to a failure to file ("FTF") penalty. The FTF penalty is calculated at a rate of 5% of the net tax due for each month, or part of a month, the return is late (maximum 25% of the additional tax due). If the tax return is filed under an extension, the late filing penalty will be assessed from the extended filing date rather than from the original due date.

A tax return filed after the due date (with a tax due) is subject to the failure to pay a tax when due penalty ("FTP"). The FTP penalty is calculated at a rate of 5% of the tax not paid by the due date of the return. If a timely extension is filed, the FTP penalty will apply on any remaining balance due if the tax paid by the due date of the return is less than 90% of the total amount of tax due. If the 90% rule is met, any remaining balance due, including interest, must be paid with the income tax return on or before the expiration of the extension period to avoid the FTP penalty. Interest is due from the due date of the tax return to the date the tax is paid.

The FTP penalty will not be assessed if the amount shown due on an amended return is paid when the amended return is filed. A proposed assessment of tax is subject to the FTP penalty if the tax is not paid within 45 days the assessment becomes collectible. For more information on requests for reviews, see Appeals Process.

Reference: G.S. § 105-236; 17 NCAC 06B .3203.

3. Large Tax Deficiency and Negligence Penalties

If a taxpayer understates taxable income equal to 25% or more of gross income, the Department is permitted to assess a 25% large individual income tax deficiency or other large tax deficiency penalty. When the percentage of understatement of taxable income is less than 25%, the Department may assess a 10% negligence penalty. The application of the 10% negligence penalty is based on the understatement of tax and will be made on the basis of the facts in each case. When an accuracy-related penalty is assessed for federal income tax purposes, the 10% negligence penalty can be assessed for North Carolina income tax purposes, unless the 25% large individual income tax deficiency or other large tax deficiency penalty applies.

A large tax deficiency penalty or a negligence penalty cannot be assessed when the fraud penalty has been assessed with respect to the same deficiency.

Reference: G.S. § 105-236(a)(5); 17 NCAC 06B .3204; 17 NCAC 06B .3404.

4. Penalties Regarding Informational Returns

The penalty for failure to file an informational return or report required by Article 4A, 5, 9, 36C, or 36D by the due date of the return or report is $50 per day, up to a maximum of $1,000. In addition, a penalty of $200 will be assessed if the informational return or report is not filed in the required format.

Reference: G.S. § 105-236(a)(10).

5. Failure to Report Federal Changes

When a taxpayer fails to report federal change or correction from a federal determination within six months from the date the taxpayer is notified by the Internal Revenue Service of the correction or final determination, the taxpayer is subject to the failure to file penalty and forfeits the right to any refund as the result of the federal changes. The failure to file penalty begins at the expiration of the six-month period.

Reference: G.S. § 105-159; G.S. § 105-236; G.S. § 105-2228.90(a)(15).

6. Fraud

When an examination of an income tax return is based on a federal audit report and the fraud penalty has been assessed for federal purposes, the 50% fraud penalty will be assessed for State purposes. The fraud penalty may also be assessed when there is a deficiency or delinquency in payment of any tax because of fraud with intent to evade the tax. When the fraud penalty is assessed, no penalty for large tax deficiency, negligence, or failure to pay shall be assessed with respect to the same deficiency; however, other penalties that apply, such as failure to file, will be assessed.

Reference: G.S. § 105-236(a)(6); 17 NCAC 06B .3206.

7. Collection Assistance Fee

Any tax, penalty, and interest not paid within 60 days after it becomes collectible under G.S. § 105-241.22 is subject to a 20% collection assistance fee (Fee"). The Fee will not apply if the taxpayer enters into an installment payment agreement with the Department before the Fee is imposed. The Fee may be imposed on defaulted installment payment agreements.

Reference: G.S. § 105-243.1.

8. Interest

Interest accrues on an underpayment of tax from the due date of the return, even if the taxpayer is granted an extension of time to file the return. Interest accrues on an overpayment of tax beginning 45 days after the latest of (1) the date the final return was filed, (2) the date the final return was due to be filed, or (3) the date of the overpayment. **Note:** The "date the final return was due to be filed" is the due date of the return; not the extended due date of the return.

The law requires the Secretary to establish the interest rate on or before June 1 for the following six-month period beginning on July 1, and on or before December 1 for the following six-month period beginning on January 1. The rate set by the Secretary may not be less than 5% per year or greater than 16% per year. For more information, see Interest Rate.

Reference: G.S. § 105-241.21.

9. Underpayment of Estimated Income Tax

Interest on the underpayment of estimated income tax is computed on Form D-422, Underpayment of Estimated Income Tax by Individuals. If interest on the underpayment is applicable, add the amount of the interest to the tax due and include the full payment with the return. For more information, see Interest on Underpayment of Estimated Income Tax.

A Taxed Pass-Through Entity may be subject to interest on the underpayment of estimated income tax if it does not pay enough estimated income tax or the estimated income tax is paid late. For more information, see Taxed Pass-Through Entities.

Reference: G.S. § 163.15; 17 NCAC 06D .0201.

10. Waiver of Penalty or Interest

The Secretary of Revenue may reduce or waive penalties pursuant to North Carolina law and the Department's Penalty Waiver Policy. A request to reduce or waive a penalty must generally be in writing and must include an explanation for the request. For more information on the penalty waiver policy, see the Department's website.

Note: In most cases, interest cannot be waived or reduced. The Secretary can reduce or waive interest if the interest is imposed on tax prior to or during a period for which the taxpayer has declared bankruptcy under Chapter 7 or Chapter 13 of Title 11 of the United States Code. The Secretary can also waive or reduce interest if specifically authorized by the North Carolina General Assembly.

Reference: G.S. § 105-237.

11. Penalty Relief for Presidentially Declared Disasters

The penalties described in G.S. § 105-236(a)(2), (3), (4), and (10)c (collectively, "Late Action Penalties") may not be assessed for any period in which the time for filing a federal return or report or for paying a federal tax is extended under section 7508A of the Code because of a presidentially declared disaster. The extension of time granted by the Internal Revenue Service under section 7508A of the Code only applies to the corresponding State tax return or payment. A "presidentially declared disaster" has the same meaning as in section 1033(h)(3) of the Code.

Note: The penalty relief provided under G.S. § 105-249.2(b) only applies to the assessment of Late Action Penalties for failure to comply with statutory requirements during the relief period. It does not extend the time for filing a North Carolina return or paying the applicable North Carolina tax due. Interest will be assessed on any tax due from the date the tax was due until the date the tax is paid. Late Action Penalties for failure to comply with statutory requirements outside of the relief period may be assessed during the relief period. Any penalty other than a Late Action Penalty also may be assessed during the relief period.

Reference: G.S. § 105-249.2(b).

XVI. Estimated Income Tax

1. Forms

Form NC-40 is the form for payment of estimated individual income tax and includes the necessary voucher for making the payment. An individual can pay estimated tax online. See the Department's eServices web page.

2. Requirements for Filing

An individual must pay estimated income tax if the tax shown due on the income tax return for the taxable year, reduced by the North Carolina tax withheld and allowable tax credits, is $1,000 or more regardless of the amount of income the individual has that is not subject to withholding. There are four required estimated income tax installments for each taxable year:

(1) First installment – April 15 of taxable year;
(2) Second installment – June 15 of taxable year;
(3) Third installment – September 15 of taxable year; and
(4) Fourth installment – January 15 of following taxable year.

Lawfully married individuals ("Married Individuals") can make joint payments of estimated income tax even if they are not living together; however, Married Individuals may not make joint estimated tax payments if the individuals are separated under a decree of divorce or of separate maintenance. Also, Married Individuals may not make joint estimated tax payments if either of them is a nonresident alien or if either of them have different tax years.

Whether Married Individuals make joint estimated tax payments or separate estimated tax payments will not affect their choice of filing a joint income tax return or a separate income tax return. If the Married Individuals make joint estimated tax payments and then file separate income tax returns, the Married Individuals must determine how to divide the estimated tax payments between the individuals.

An individual filing a short period income tax return because of a change in income year is required to make estimated income tax payments on the installment dates which fall within the short period and 15 days after the close of the short period. Estimated tax payments should be calculated in the same manner as if the income year had not changed. Interest on the underpayment of estimated income tax for a short period will be computed for the period of underpayment based on the tax shown due on the short period tax return and computed in the same manner as it would have been computed had the taxpayer not changed his or her income year.

Reference: G.S. § 105-163.15; 17 NCAC 06D .0102; I.R.C. § 6654(e).

3. Applying an Income Tax Refund to Estimated Income Tax

An individual entitled to an income tax refund for the current year may elect to apply part or all of the tax refund to the individual's estimated income tax liability for the following year. The election is made on the North Carolina individual income tax return ("NC Return"). The NC Return must be filed by the last allowable date for making an estimated tax payment for the following tax year. When an individual makes a valid election, the individual cannot revoke the election after the NC Return has been filed.

Example 1: *A taxpayer filed a NC Return for tax year 2025 on April 15, 2026. The NC Tax Return reflects an overpayment. The taxpayer elected to have all the overpayment applied to estimated income tax.*

Because the taxpayer filed the NC Return on or before the last allowable day to make an estimated tax payment for tax year 2026 (i.e., January 15, 2027), the Department applied the overpayment to tax year 2026.

Example 2: *A taxpayer filed a NC Return for tax year 2024 on June 1, 2026. The NC Return reflects an overpayment. The taxpayer elected to have all the overpayment applied to estimated income tax.*

Because the taxpayer filed the NC Return after the last allowable day to make an estimated tax payment for tax year 2025 (i.e., January 15, 2026), the Department can not apply the overpayment to tax year 2025. The Department must refund the overpayment in accordance G.S. §§ 105-241.6 and 105-241.7.

Example 3: *A taxpayer timely a NC Return for tax year 2025 on April 15, 2026. The NC Tax Return reflects an overpayment. The taxpayer elected to have all the overpayment applied to estimated income tax.*

Because the taxpayer filed the NC Return on or before the last allowable day to make an estimated tax payment for tax year 2025 (i.e., January 15, 2027), the Department applied the overpayment to tax year 2026.

On December 15, 2026, the taxpayer amends the NC Return for tax year 2025 and requests a refund of an overpayment. In calculating the overpayment, the taxpayer included the amount of estimated tax previously applied to tax year 2026.

Because the taxpayer made a valid election to apply the 2025 overpayment to tax year 2026, the Department cannot refund the amount of estimated tax applied to tax year 2026.

Reference: G.S. § 105-269.4; 17 NCAC 06D .0102.

4. Taxed Pass-Through Entities

A Taxed Pass-Through Entity is required to make estimated income tax payments if the Taxed Pass-Through Entity expects to have a North Carolina income tax liability of $500 or more. For more information, see Taxed Pass-Through Entities.

Reference: G.S. § 105-163.39.

XVII. Interest on the Underpayment of Estimated Income Tax

1. General

Interest may be due on an underpayment of estimated income tax. Interest is computed separately for each payment period; therefore, an individual may owe interest for an early period even if that individual later paid enough to make up the underpayment. An individual who did not pay enough tax by the due date of each of the payment periods may owe interest even if a refund is due when the return is filed.

Reference: G.S. § 105-163.15; 17 NCAC 06D .0201.

2. Avoiding Interest on the Underpayment

Interest on the underpayment of estimated income tax will not apply if the individual makes payments of estimated income tax on each installment date for 25% of the lesser of the following:

a. 90% (66.67% for farmers and fishermen) of the tax (after tax credits) on the current year's return,

b. 100% of the tax on the preceding year's return (provided it was a taxable year of 12 months and the individual filed a return for that year), or

c. 90% (66.67% for farmers and fishermen) of the tax determined by annualizing the income received during the year up to the month in which the installment is due.

For the purposes of this section, the preceding year's tax refers to the taxpayer's original return, or the taxpayer's amended return for the previous year if the amended return was filed prior to the due date for that year, including extensions.

In addition, no interest on an underpayment will be due if an individual had no tax liability for the preceding year or if the total tax shown on the current year return minus tax credits and the amount paid through withholding is less than $1,000.

3. Underpayments

An underpayment is the excess of the required installment (or, if lower, the annualized income installment) for a payment period over the portion of the amount paid by the due date that is not applied to an underpayment for an earlier payment period.

Payments include income tax withheld, which are considered payments of estimated tax in equal installments on the required installment dates (usually four), unless the individual can prove otherwise. A payment of estimated tax is credited against unpaid installments in the order in which the installments are required to be paid.

Reference: 17 NCAC 06D .0207.

4. Overpayments

An overpayment for any period occurs when the withholding and estimated income tax payments are more than the total of any underpayments for an earlier period plus the lesser of the required installment or the annualized income installment for the period. If there is an overpayment for a period, it should be carried to the next period and added to the withholding and estimated income tax paid for that later period to determine any underpayment or overpayment for that later period.

Reference: 17 NCAC 06D .0208.

5. Determining an Underpayment

No interest will be due if the estimated income tax payments were made on time and the payment for each period was at least as much as either the required installment or the annualized income installment for the period. To determine an underpayment, use Form D-422, Underpayment of Estimated Tax by Individuals.

The required installment for any payment period is the lesser of 22.5% of the tax shown on the current year income tax return or 25% of the tax shown on the prior-year income tax return (if the prior-year return covered all 12 months of the year). However, if the annualized income installment for any period is less than the required installment for the same period and the annualized income installment is used in determining the underpayment, add the difference between the annualized income installment and the required installment to the required installment for the next period. If the annualized income installment for the next payment period is used, add the difference between the annualized income installment for that period and the required installment (as increased) for that period to the required installment for the following payment period.

There will be no underpayment for any payment period in which the estimated income tax payments, reduced by any amounts applied to underpayments in earlier periods, were paid by the due date for the period and were at least as much as the annualized income installment for the period.

Reference: 17 NCAC 06D .0209.

6. Period of Underpayment

Underpayment interest is applied to the number of days that the installment was not paid. For tax year 2025, for example, determine the period of the underpayment by counting the number of days after the due date of the installment to and including the date of payment, or April 15, 2026, whichever is earlier. Fiscal year taxpayers use the 15th day of the 4th month following the close of the fiscal year instead of April 15, 2026.

Calendar year taxpayers' payments are due on April 15, June 15, and September 15, and January 15 of the following year. If the 15th of the month is on a weekend or holiday, the payment is due on the next business day.

Payments for fiscal year taxpayers are due on the 15th day of the 4th month, the 15th day of the 6th month, and the 15th day of the 9th month of the fiscal year, and the 15th day of the 1st month after the end of the fiscal year.

Periods and amounts of underpayment are determined by applying estimated tax payments to any underpayments of earlier installments in the order in which such installments were required to be paid.

If a payment of estimated tax is applied to an underpayment for an earlier period, but the payment is less than the underpayment, there will be more than one period of underpayment for the earlier period.

The first period of underpayment for any payment period will be from the day after the due date for the payment period to the date of the first applied payment. Later periods of underpayment for that payment period will be from the day after the due date for the payment period to the date of the next applied payment or April 15 of the following year, whichever is earlier.

To determine the interest for a payment period with more than one period of underpayment, compute interest separately for each of the periods of underpayment using the number of days in each period of underpayment, the correct underpayment balance, and the appropriate interest rates.

Reference: 17 NCAC 06D .0210.

7. Farmers and Fishermen

The following special rules for underpayment of estimated tax apply to farmers and fishermen:

a. Interest for underpaying 2025 estimated tax will not apply if the return is filed and all tax is paid by March 1, 2026. For fiscal year taxpayers, interest will not apply if the return is filed and tax due is paid by the first day of the third month after the end of the tax year.

b. Any interest owed for underpaying 2025 estimated tax will be determined from one payment due date, January 15, 2026.

c. Underpayment interest for 2025 is computed on the difference between the amount of estimated tax paid by the due date and the lesser of 100% of the tax shown on the 2024 return or 66.67% of the 2025 tax.

Note: In addition to the special rules, farmers and fishermen will not have to pay underpayment interest if the tax due (less withholding and tax credits) is less than $1,000 or if there was no tax liability for the prior year.

8. Taxed Pass-Through Entities

A Taxed Pass-Through Entity must generally make estimated income tax payments if the Taxed Pass-Through Entity expects to have a North Carolina income tax liability of $500 or more. A Taxed Pass-Through Entity that does not make the required estimated tax payments may be subject to interest for underpayment of estimated income tax.

For more information, see Taxed Pass-Through Entities.

Reference: G.S. § 105-163.39.

9. Joint and Separate Returns

a. Joint Estimated Tax Payments

Lawfully married individuals ("Married Taxpayers") may make joint estimated income tax payments in most circumstances. However, Married Taxpayers that are legally separated under a decree of divorce or have different tax years cannot make joint estimated income tax payments. In addition, if either spouse is a nonresident alien (unless that spouse elected to be treated as a resident alien for tax purposes), the Married Taxpayers cannot make a joint estimated income tax payment.

b. Calculating Preceding Year's Tax for Joint Returns

For the purposes of determining whether there has been an underpayment of tax for the current year, a taxpayer may need to determine the amount of the preceding year's tax. Lawfully married individuals who plan to file a North Carolina individual income tax return jointly with their spouse in the current tax year, and who also filed a North Carolina income tax return jointly with the same spouse in the preceding tax year, may simply use the income tax amount on the preceding year's joint income tax return.

Lawfully married individuals who plan to file a North Carolina individual income tax return jointly with their spouse in the current tax year, but who filed a North Carolina individual income tax return separately from their spouse in the preceding tax year, must add the income tax on each separate tax return from the preceding tax year to determine the preceding year's income tax.

c. Calculating Preceding Year's Tax for Separate Returns

For the purposes of determining whether there has been an underpayment of income tax for the current tax year, an individual may need to determine the amount of the preceding year's income tax.

Two lawfully married individuals who plan to file separate North Carolina individual income tax returns in the current tax year, and who also filed separate North Carolina individual income tax returns in the preceding tax year, can simply use the income tax amount from the preceding tax year's tax return.

Two lawfully married individuals who plan to file separate North Carolina individual income tax returns in the current tax year, but who filed a joint North Carolina individual income tax return with the same spouse in the preceding tax year, must determine each spouse's share of income tax from the preceding year's tax return. To determine an individual spouse's share of income tax from a joint North Carolina individual income tax return, each individual spouse must first determine the amount of income tax each spouse would have paid in the preceding tax year had each individual spouse filed a separate North Carolina income tax return (using the filing status the individual spouse plans to use for the current tax year). The individual spouse must then multiply the income tax on the preceding year's joint income tax return by the following fraction:

$$\frac{\text{Individual's North Carolina income tax due if a separate North Carolina income tax return were filed in the preceding tax year}}{\text{Total income tax due from both spouses if separate North Carolina income tax returns were filed in the preceding tax year}}$$

XVIII. Critical Infrastructure Disaster Relief Work

1. General

G.S. § 166A-19.70A excludes 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 from certain tax and regulatory requirements.

A **nonresident business** is defined as an entity that has not been required to file an income or franchise tax return with North Carolina 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 Session Law 2019-187. The entity must either be a nonresident entity as defined in G.S. § 105-163.1 or a nonresident individual who owns an unincorporated business as a sole proprietor.

A **nonresident employee** is defined as a nonresident individual who is an employee of a nonresident business or an employee of a critical infrastructure company who is temporarily in this State to perform disaster-related work during a disaster response period.

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).

Reference: G.S. § 166A-19.70A; G.S. § 166A-19.3.

2. Common Questions

- **When does a "disaster response period" begin?**
  The disaster response period begins 10 days prior to the first day of a disaster declaration.

- **When does a "disaster response period" end?**
  The disaster response period ends on the earlier of the following:

  1. Sixty days following the expiration of the disaster declaration, as provided under G.S. § 166A-19.21(c).

  2. One hundred eighty days following the issuance of the disaster declaration.

- **What is a "disaster declaration?"**
  A gubernatorial declaration that the impact or anticipated impact of an emergency constitutes a disaster of one of the types enumerated in G.S. § 166A-19.21(b).

- **What is considered "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.

- **What is a "critical infrastructure company?"**
  A registered public communications provider or a registered public utility. A registered public communications provider is a corporation doing business in North Carolina prior to the disaster declaration that provides the transmission to the public of one or more of the following: Broadband; Mobile telecommunications; Telecommunications; or Wireless Internet access.

  A registered public utility is a corporation doing business in North Carolina prior to the disaster declaration that is subject to the control of one or more of the following entities: the North Carolina Utilities Commission; the North Carolina Rural Electrification Authority; the Federal Communications Commission; or the Federal Energy Regulatory Commission.

  Reference: G.S. § 166A-19.70A; G.S. § 166A-19.3.

3. Applicability to Individuals

a. General

A nonresident individual who solely derives income from North Carolina sources attributable to a business, trade, profession, or occupation carried on in North Carolina to perform disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file a North Carolina individual income tax return. This exclusion applies whether the nonresident individual is a nonresident business or a nonresident employee as defined by G.S. § 166A-19.70A.

Reference: G.S. § 166A-19.70A; G.S. § 105-153.8(a).

b. Limitation

The relief does not apply to any tax year that is part of the disaster response period if the nonresident individual continues to perform disaster-related work following the end of the disaster response period. The relief also does not apply to a tax year that is part of the disaster response period if the nonresident individual 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.

Reference: G.S. § 166A-19.70A; G.S. § 105-153.8(a).

c. Examples

Example 1. *Taxpayer is employed by a critical infrastructure company. Taxpayer is domiciled in Tennessee. Taxpayer arrives in North Carolina during the disaster response period at the request of a critical infrastructure company to perform disaster related work.*

Taxpayer is not required to file or pay North Carolina individual income tax for the income earned in North Carolina attributable to the disaster-related work during the disaster response period.

Example 2. *Same facts as Example 1, except Taxpayer also owns a rental house in North Carolina for which he receives rental income.*

Taxpayer is required to file a North Carolina individual income tax return due to the rental income earned in North Carolina. As a result, Taxpayer will be required to file and pay tax as a nonresident on all income attributable to North Carolina, including wage income earned for disaster-related work.

Example 3. *Taxpayer is a sole proprietor domiciled in Georgia. Taxpayer has no filing requirement with North Carolina prior to the disaster response period. During the disaster response period, Taxpayer independently comes to North Carolina to perform repair work following the disaster.*

Taxpayer did not come to North Carolina at the request of a critical infrastructure company. Therefore, Taxpayer must file and pay North Carolina tax on the income earned in North Carolina.

Example 4. *Taxpayer is employed by a nonresident business. Taxpayer is domiciled in South Carolina. A critical infrastructure company requests Taxpayer's employer to perform disaster-related work during a disaster response period in North Carolina. Taxpayer performs disaster-related work in North Carolina in the course of his employment with the nonresident business during a disaster response period.*

Taxpayer is not required to file or pay North Carolina individual income tax for the income earned in North Carolina attributable to the disaster-related work during the disaster response period.

Example 5. *Individual 1 is a resident of South Carolina. A critical infrastructure company employs Individual 1 to perform disaster-related work during a disaster response period in North Carolina. Individual 1 is married to Individual 2. Individual 2, also a resident of South Carolina, is employed in North Carolina.*

If Individual 1 and Individual 2 elect to file a joint North Carolina individual income return, Individual 1 will be required to pay North Carolina tax on income earned in North Carolina for performing disaster-related work. If Individual 2 does not file a joint North Carolina individual income tax return with Individual 1, but instead files a married filing separate

North Carolina individual income tax return, Individual 1's income earned in North Carolina for performing disaster-related work will not be included on Individual 2's North Carolina tax return. Moreover, Individual 1 will not be required to file a North Carolina individual income tax return.

4. Applicability to Pass-Through Entities

a. General

G.S. § 105-131.7 provides that an S Corporation that is not doing business in North Carolina because it is a nonresident business performing disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file a return with the Department.

Similarly, G.S. § 105-154(c) was amended to provide that a partnership that is not doing business in North Carolina because it is a nonresident business performing disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file an information return with the Department.

Reference: G.S § 105-131.7; G.S. § 105-154.

b. Limitation

The relief does not apply to any tax year that is part of the disaster response period if the nonresident business continues to perform disaster-related work following the end of the disaster response period. The relief does not apply to a tax year that is part of the disaster response period if the nonresident business 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.

c. Shareholder and Partner Information Requirements

A nonresident shareholder or partner is only relieved of his or her North Carolina filing responsibility if the nonresident meets all of the provisions of the law. If the nonresident shareholder or partner is subject to North Carolina taxation, that person will need information from the S corporation or the partnership to properly file his or her North Carolina tax return.

However, the S Corporation or partnership may not have sufficient information to determine whether a nonresident shareholder or partner is subject to North Carolina tax. Consequently, pass-through entities exempted from a filing requirement under the law must still provide to each shareholder or partner any information necessary for that person to file a North Carolina income tax return.

Reference: G.S. § 105-131.7; G.S. § 105-154.

d. Examples

Example 1. *In 2025, a nonresident partnership (Partnership ABC) performs disaster-related services in North Carolina during a disaster response period at the request of a critical infrastructure company. Partnership ABC has one resident partner and one nonresident partner.*

For tax year 2025, Partnership ABC is not doing business in North Carolina and is not required to file an information return (Form D-403) with the Department. Partnership ABC must issue income information (Schedule D-403 K-1) to each partner for 2025.

Example 2. *In 2025, Partnership XYZ makes and sells widgets at its retail location in North Carolina. Partnership XYZ also performs disaster-related services in North Carolina during a disaster response period at the request of a critical infrastructure company. Partnership XYZ has two nonresident partners.*

For tax year 2025, Partnership XYZ is doing business in North Carolina and is required to file an information return (Form D-403) with the Department. Partnership XYZ must also issue income information (Schedule D-403 K-1) to each partner for 2025.

Example 3. *Partner A is a nonresident partner in Partnership ABC from Example 1 with no other income derived from North Carolina sources in 2025.*

Partner A will receive income information (Schedule D-403 K-1) from Partnership ABC for 2025. Partner A will not be required to pay North Carolina individual income tax or file a North Carolina individual income tax return for 2025.

Example 4. *Partner B is a partner in both Partnership ABC and Partnership XYZ from Examples 1 and 2.*

Partner B will receive income information (Schedule D-403 K-1) from Partnership ABC and Partnership XYZ for 2025. Because Partner B derives income from North Carolina sources attributable to a business carried on in North Carolina that is not related to disaster-related work, Partner B is subject to North Carolina tax on income earned from both Partnership ABC and Partnership XYZ. Partner B is required to file an individual income tax return (Form D-400) with the Department.

5. Applicability to Withholding

a. Wages

Amounts paid to a nonresident employee for a business, trade, profession, or occupation carried on in North Carolina to perform disaster-related work during a disaster response period at the request of a critical infrastructure company are not considered wages. As such, these amounts are excluded from the withholding requirements of G.S. § 105-163.2 and employers are not required to withhold from the amounts the State income taxes payable by the employee.

Reference: G.S. § 105-163.1; G.S. § 105-163.2.

b. Nonwage Compensation

The withholding requirements of G.S. § 105-163.3 for nonwage compensation do not apply to compensation paid by a nonresident business or a critical infrastructure company to an ITIN contractor who is a nonresident individual for a business, trade, profession, or occupation carried on in this State to perform disaster-related work during a disaster response period at the request of a critical infrastructure company.

Reference: G.S. § 105-163.3.

c. Informational Return Requirements under G.S. § 105-163.7

A nonresident business employer performing disaster-related work during a disaster response period at the request of a critical infrastructure company is not required to file an information return with the Secretary under G.S. § 105-163.7. However, the employer must furnish to an employee, upon request, any information necessary for that person to properly file a State income tax return.

Reference: G.S. § 105-163.7.

6. Required Notifications

a. Critical Infrastructure Company Notification

A critical infrastructure company must provide notification to the Department within 90 days of the expiration of the disaster response period on Form NC-CICN: Critical Infrastructure Company Notification. The critical infrastructure company notification must include the following information for each nonresident businesses who performed disaster-related work in this State during a disaster response period at the request of the critical infrastructure company:

- The legal name of the nonresident business.
- The taxpayer identification number of the nonresident business.
- The principal address of the nonresident business.
- The date of entry into North Carolina for the nonresident business.
- The date of exit from North Carolina for the nonresident business.

The critical infrastructure notification must include the following information for each nonresident employee of the critical infrastructure company who performed disaster-related work in this State for the critical infrastructure company during a disaster response period:

- The legal name of the nonresident employee.
- The social security number of the nonresident employee.
- The principal address of the nonresident employee.
- The date of entry into North Carolina for the nonresident employee.
- The date of exit from North Carolina for the nonresident employee.
- The amount of compensation paid to the nonresident employee for performing disaster-related work in North Carolina for each calendar year the nonresident employee performed disaster-related work.

b. Nonresident Business Notification

A nonresident business must provide notification to the Department within 90 days of the date the nonresident business concludes its disaster-related work in the State on Form NC-NBN, Nonresident Business Notification. The nonresident business notification must include the following information for each nonresident employee of the nonresident business who performed disaster-related work in this State for the nonresident business during a disaster response period:

- The legal name of the nonresident employee.
- The social security number of the nonresident employee.
- The principal address of the nonresident employee.
- The date of entry into North Carolina for the nonresident employee.
- The date of exit from North Carolina for the nonresident employee.
- The amount of compensation paid to the nonresident employee for performing disaster-related work in North Carolina for each calendar year the nonresident employee performed disaster-related work.

A nonresident business that fails to submit this timely notification to the Department forfeits the relief provided by Session Law 2019-187. Consequently, it is not excluded from and must abide by North Carolina's tax and regulatory requirements. However, the disqualification of a nonresident business for failure to timely provide notification does not automatically disqualify the nonresident employees of the nonresident business. Those employees are still eligible for the relief specified in Session Law 2019-187 if they meet the requirements of the statute.

Reference: Session Law 2019-187.

XIX. Income Tax Adjustments for IRC Section 179 Expenses

1. General

North Carolina does not conform to the same IRC section 179 expensing limitations allowed for federal income tax purposes. Instead, North Carolina has separate dollar and investment limitations. For tax year 2025, the North Carolina limitations are as follows:

North Carolina Dollar Limitations	North Carolina Investment Limitations
$ 25,000	$200,000

An individual income taxpayer that places Code section 179 property in service during a taxable year must add to federal adjusted gross income an amount equal to 85% of the difference between the amount deducted on the federal return for Code section 179 expenses, using the federal dollar and federal investment limitations, and the amount that would be deductible for Code section 179 expenses using the North Carolina dollar and North Carolina investment limitations. If the cost of all qualifying Code section 179 property placed in service during the taxable year exceeds the North Carolina investment limitation for a given year, a taxpayer must reduce the North Carolina dollar limitation, but not below zero, by the amount the cost of all qualifying Code section 179 property placed in service during the taxable year exceeds the North Carolina investment limitation. The add-back is calculated as follows:

Add-back = (Deduction on Federal Return – Deduction Using North Carolina Dollar and Investment Limitations) X 85%.

A taxpayer may deduct an amount equal to 20% of the total amount of Code section 179 expense added to federal adjusted gross income in each of the first five taxable years following the taxable year in which the add-back is reported.

See Examples 1 through 4 in Important Notice: Income Tax Adjustments For Code Section 179 Expenses (revised on June 20, 2014 to reflect recent legislative changes) for examples of how to determine the add-back for investments in Code section 179 property.

Reference: G.S. § 105-153.5; G.S. § 105-153.6.

2. Code Section 179 Investments and Pass-through Entities

a. General

A corporation or individual, in addition to its own investments in qualifying Code section 179 property, may be an owner of a pass-through entity that also invests in qualifying Code section 179 property. For both federal and North Carolina income tax purposes, the Code section 179 deduction limitations apply both to the pass-through entity and to each of its owners. The pass-through entity determines its Code section 179 deduction subject to the applicable limitations but does not deduct the allowable expense on the pass-through entity tax return. Instead, it allocates the Code section 179 expense deduction among its owners.

b. Taxed Partnership

A separately stated item of deduction, as described in section 702 of the Code, is not included when calculating each partner's distributive share of the Taxed Partnership's North Carolina taxable income. For more information, see Taxed Pass-Through Entities**.**

c. Statement Required

For federal income tax purposes, the pass-through entity reports the owner's allocated share of the federal Code section 179 deduction on the owner's federal K-1. For North Carolina income tax purposes, if a pass-through entity has allocated a Code section 179 expense to its owners for federal income tax purposes, the pass-through entity must provide a statement on each North Carolina K-1 that notifies the owner that North Carolina's dollar and investment limitations are different than the federal limitations and an addition may be required on the owner's North Carolina income tax return. The statement must also provide the amount of Code section 179 expense allocated to the owner using the North Carolina limitations.

Sample language that may be used by the pass-through entity is as follows:

You have been allocated Code section 179 expenses on your federal K-1 based on federal dollar and investment limitations. North Carolina has different dollar and investment limitations and requires an add-back on the North Carolina income tax return for 85% of the difference between the amount deducted on the federal return for Code section 179 expenses and the amount of Code section 179 expenses that would be deductible using the North Carolina dollar and investment limitations. The amount of Code section 179 expenses that would be allocated to you using North Carolina's dollar and investment limitations is $___. Use this amount in calculating the add-back for Code section 179 expense on your North Carolina return.

You are allowed to take a deduction in each of the first five taxable years following the taxable year in which the add-back is reported. The deduction in each of those years is 20% of the add-back.

d. Reporting

The pass-through entity does not report the add-back or the subsequent deductions on the pass-through entity income tax return.

The total investment in Code section 179 property by the pass-through entity is not added to the owner's own investments when applying the investment limitation. However, the owner of the pass-through entity must add the amount of Code section 179 expense allocated to it by a pass-through entity to its own Code section 179 investments before applying the dollar limitation.

See Examples 5 through 8 in Important Notice: Income Tax Adjustments For Code Section 179 Expenses (revised on June 20, 2014) for examples of how a pass-through entity determines the amount to include in the statement on each owner's NC K-1 and how the owner determines the add-back for investments in Code section 179 property.

XX. Bonus Asset Basis

1. General

Taxpayers are allowed 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.

Reference: G.S. § 105-153.6(e).

2. Definitions

Transferor. An individual, partnership, corporation, S corporation, limited liability company, or an estate or trust that does not fully distribute income to its beneficiaries.

Owner in a transferor. One or more of the following of a transferor:
- A partner, shareholder, or member.
- A beneficiary subject to North Carolina income taxation.

Remaining life of the asset. The remaining years in the asset's federal recovery period, as determined under section 168(c) of the Code.

3. Bonus Asset Basis Adjustments

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

a. There is an actual or deemed transfer of an asset;

b. The tax basis of the transferred asset carries over from the transferor to the transferee for federal income tax purposes; and

c. Each transferor or owner in a transferor that added bonus depreciation to its federal taxable income or adjusted gross income, as appropriate, certifies in writing that they will not take any remaining future State bonus depreciation deductions associated with the transferred asset.

When the above requirements are met, the transferee is eligible to deduct the remaining bonus depreciation deductions associated with the transferred asset. An adjustment to federal adjusted gross income is required for each year the asset with the bonus asset basis is depreciated. In addition, upon sale or other 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.

4. Examples

A taxpayer is required to make an addition on the North Carolina return equal to a percentage of the amount of the bonus depreciation deducted on the federal return. The amount of the addition is then deducted ratably over a future five-year period. For example, a taxpayer makes an addition on the 2020 North Carolina return for 85% of the bonus depreciation deducted on the 2020 federal return. The taxpayer may then deduct 20% of the amount of the addition on each of the taxpayer's 2021 through 2025 North Carolina returns.

Pursuant to G.S. § 105-153.6(d), State adjustments for bonus depreciation do not result in a difference in basis for State and federal purposes, with the exception of when a bonus asset basis is created as described in this section.

Example 1. Taxpayer A purchased property on January 1, 2015, for $100,000. The property qualified as 3-year property for federal depreciation purposes. The property also qualified for 100% bonus depreciation. On January 1, 2018, the property was transferred to Taxpayer B in an exchange resulting in Taxpayer A's tax basis in the property transferring to Taxpayer B. Taxpayer A and all owners in Taxpayer A certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred.

Taxpayer A's depreciation, basis, and State additions and deductions for 2015 through 2017 are as shown below.

Taxpayer A (Transferor)	**2015**	**2016**	**2017**
Federal Bonus Depreciation	$100,000	$ 0	$ 0
Federal Straight-Line Depreciation	0	0	0
Federal Basis (after depreciation)	0	0	0
State Bonus Depreciation Addition	85,000	0	0
State Bonus Depreciation Deduction	0	17,000	17,000
State Basis	0	0	0

Taxpayer A is not entitled to a State bonus depreciation deduction in years after 2017.

Taxpayer B's federal tax basis in the property at the time of transfer is $0 and the State bonus asset tax basis is $51,000 calculated as follows:

Taxpayer A's Original Basis	$100,000
Less: Taxpayer A's Federal Depreciation	(100,000)
Plus: State Bonus Depreciation Addition	85,000
Less: State Bonus Depreciation Deductions	(34,000)
State Bonus Asset Basis as of January 1, 2018	**$ 51,000**

Taxpayer B's depreciation, basis, and State Bonus Asset Basis deductions for 2018 are as shown below.

Taxpayer B (Transferee)	**2018**
Federal Bonus Depreciation	0
Federal Straight-Line Depreciation	0
Federal Basis (after depreciation)	0
State Bonus Asset Basis	$51,000
State Bonus Asset Basis Deduction	$51,000
State Basis (after deduction)	0

Because there is no remaining life of the property pursuant to section 168(c), Taxpayer B is entitled to a deduction in 2018, the year of transfer, for the cumulative remaining bonus depreciation deductions allowable to Taxpayer A at the time of transfer. Therefore, Taxpayer B is not entitled to a State bonus asset basis deduction in years after 2018.

Example 2. Taxpayer C purchased property on January 1, 2014, for $100,000. The property qualified as 5-year property for federal depreciation purposes. The property also qualified for 100% bonus depreciation. On January 1, 2016, the property was transferred to Taxpayer D in an exchange resulting in Taxpayer C's tax basis in the property transferring to Taxpayer D. Taxpayer C and all owners in Taxpayer C certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred.

Taxpayer C's depreciation, basis, and State additions and deductions for 2014 and 2015 are as shown below.

Taxpayer C (Transferor)	**2014**	**2015**
Federal Bonus Depreciation	$ 100,000	$ 0
Federal Straight-Line Depreciation	0	0
Federal Basis (after depreciation)	0	0
State Bonus Depreciation Addition	85,000	0
State Bonus Depreciation Deduction	0	17,000
State Basis	0	0

Taxpayer C is not entitled to a State bonus depreciation deduction in years after 2015.

Taxpayer D's federal tax basis in the property at the time of transfer is $0 and the State bonus asset tax basis is $68,000 calculated as follows:

Taxpayer C's Original Basis	$100,000
Less: Taxpayer C's Federal Depreciation	(100,000)
Plus: State Bonus Depreciation Addition	85,000
Less: State Bonus Depreciation Deductions	(17,000)
State Bonus Asset Basis as of January 1, 2016	**$68,000**

Taxpayer D (Transferee)	**2016**	**2017**	**2018**
Federal Bonus Depreciation	$ 0	$ 0	$ 0
Federal Straight-Line Depreciation	0	0	0
Federal Basis (after depreciation)	0	0	0
State Bonus Asset Basis	68,000	45,333	22,666
State Bonus Asset Basis Deduction	22,667	22,667	22,666
State Basis (after deductions)	45,333	22,667	0

Taxpayer D's bonus asset basis deduction beginning in tax year 2016 is calculated as follows:

Remaining Bonus Depreciation of Transferor	$68,000
Divided by the Remaining Life of the Asset	÷ 3
Bonus Asset Basis Deduction	$22,667

Taxpayer D is not entitled to a State Bonus Asset Basis deduction in years after 2018.

Example 3. Taxpayer E purchased property on January 1, 2010, for $100,000. The property qualified as 5-year property for federal depreciation purposes. The property also qualified for 50% bonus depreciation. On January 1, 2013, the property was transferred to Taxpayer F in an exchange resulting in Taxpayer E's tax basis in the property transferring to Taxpayer F. Taxpayer E and all owners in Taxpayer E certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred.

Taxpayer E's depreciation, basis, and State additions and deductions for 2010 through 2012 are as shown below.

Taxpayer E (Transferor)	**2010**	**2011**	**2012**
Federal Bonus Depreciation	$ 50,000	$ 0	$ 0
Federal Straight-Line Depreciation	10,000	10,000	10,000
Federal Basis (after depreciation)	40,000	30,000	20,000
State Bonus Depreciation Addition	42,500	0	0
State Bonus Depreciation Deduction	0	8,500	8,500
State Basis	40,000	30,000	20,000

Taxpayer E is not entitled to a State bonus depreciation deduction in years after 2012.

Taxpayer F's federal tax basis in the property at the time of transfer is $20,000 and the State bonus asset tax basis is $45,500 calculated as follows:

Taxpayer F's Original Basis	$100,000
Less: Taxpayer F's Federal Depreciation	(80,000)
Plus: State Bonus Depreciation Addition	42,500
Less: State Bonus Depreciation Deductions	(17,000)
State Bonus Asset Basis as of January 1, 2013	**$ 45,500**

Taxpayer F (Transferee)	**2013**	**2014**
Federal Bonus Depreciation	$ 0	$ 0
Federal Straight-Line Depreciation	10,000	10,000
Federal Basis (after depreciation)	10,000	0
State Bonus Asset Basis	45,500	22,750
State Bonus Asset Basis Deduction	12,750	12,750
State Basis (after federal and State deductions)	22,750	0

Taxpayer F's bonus asset basis deduction beginning in tax year 2013 is calculated as follows:

Remaining Bonus Depreciation of Transferor	$25,500
Divided by the Remaining Life of the Asset	÷ 2
Bonus Asset Basis Deduction	$12,750

Taxpayer F is not entitled to a State Bonus Asset Basis deduction in years after 2014.

Example 4. Taxpayer G purchased property on January 1, 2010, for $100,000. The property qualified as 10-year property for federal depreciation purposes. The property also qualified for 50% bonus depreciation. On January 1, 2013, the property was transferred to Taxpayer H in an exchange resulting in Taxpayer G's tax basis in the property transferring to Taxpayer H. Taxpayer G and all owners in Taxpayer G certified in writing that they would not take any remaining bonus depreciation deductions associated with the property transferred. On January 1, 2015, Taxpayer H sells the property in a taxable exchange for $200,000.

Taxpayer G's depreciation, basis, and State additions and deductions for 2010 through 2012 are as shown below.

Taxpayer G (Transferor)	**2010**	**2011**	**2012**
Federal Bonus Depreciation	$ 50,000	$ 0	$ 0
Federal Straight-Line Depreciation	5,000	5,000	5,000
Federal Basis (after depreciation)	45,000	40,000	35,000
State Bonus Depreciation Addition	42,500	0	0
State Bonus Depreciation Deduction	0	8,500	8,500
State Basis	45,000	40,000	35,000

Taxpayer G is not entitled to a State bonus depreciation deduction in years after 2012.

Taxpayer H's federal tax basis in the property at the time of transfer is $35,000 and the State bonus asset tax basis is $60,500 calculated as follows:

Taxpayer G's Original Basis	100,000
Less: Taxpayer G's Federal Depreciation	(65,000)
Plus: State Bonus Depreciation Addition	42,500
Less: State Bonus Depreciation Deductions	(17,000)
State Bonus Asset Basis as of January 1, 2013	**$ 60,500**

Taxpayer H (Transferee)	**2013**	**2014**	**2015**
Federal Bonus Depreciation	$ 0	$ 0	$ 0
Federal Straight-Line Depreciation	5,000	5,000	0
Federal Gain (Loss)	N/A	N/A	175,000
Federal Basis (after depreciation)	30,000	25,000	N/A
State Bonus Asset Basis	60,500	51,857	43,214
State Bonus Asset Basis Deduction	3,643	3,643	18,214
State Basis (after federal and State deductions)	51,857	43,214	N/A

2013 and 2014 Bonus Asset Basis Deduction Calculation

Taxpayer H's bonus asset basis deduction beginning in tax year 2013 is calculated as follows:

Remaining Bonus Depreciation of Transferor	$25,500
Divided by the Remaining Life of the Asset	÷ 7
Bonus Asset Basis Deduction	$3,643 (rounded)

2015 State Deduction Calculation

At the time the property was sold, Taxpayer H's State tax basis was $18,214 more than the federal tax basis; therefore, Taxpayer H is entitled to a deduction of $18,214 on the State return for the difference in the gain for federal and State purposes. The gains were computed as shown below:

	Federal	**State**
Proceeds from the sale	$ 200,000	$ 200,000
Tax Basis at the time of sale	25,000	43,214
Gain (Loss)	175,000	156,786

Taxpayer H is not entitled to a State bonus asset deduction in years after 2015.

XXI. Net Operating Losses

1. General

Taxpayers cannot deduct the federal net operating loss ("Federal NOL") but are allowed to deduct the North Carolina net operating loss ("NC NOL"). The NC NOL may be carried forward for 15 years but cannot be carried back to a prior year.

The amount of a Federal NOL deducted on a taxpayer's federal return must be added back when calculating the taxpayer's North Carolina taxable income. However, an individual is authorized to utilize a portion of a Federal NOL carryover that was not absorbed in tax years beginning prior to January 1, 2022, as part of the NC NOL.

Reference: G.S. § 105-153.5A.

2. Calculating North Carolina Net Operating Losses

G.S. § 105-153.5A(a) defines an NC NOL as the amount by which business deductions for the year exceed income for the year as determined under the Code, adjusted as provided in G.S. § 105-153.5 and G.S. § 105-153.6.

The amount of a taxpayer's NC NOL must also be determined in accordance with the following modifications:

1. No NC NOL deduction is allowed.
2. The amount deductible because of losses from sales or exchanges of capital assets cannot exceed the amount includable on account of gains from sales or exchanges of capital assets.
3. The exclusion provided by Code section 1202 is not allowed.
4. The North Carolina child deduction provided by G.S. § 105-153.5(a1) is not allowed.
5. Deductions which are not attributable to a taxpayer's trade or business are allowed only to the extent of the amount of the gross income not derived from such trade or business.
6. Any deduction under Code section 199A is not allowed.

Taxpayers must use Part 1 of Form NC-NOL, Net Operating Loss Worksheet, to determine the amount of NC NOL incurred. Additional information about calculating the NC NOL is available in the Instructions for Form NC-NOL.

Note: Nonresidents and part-year residents are required to make additional adjustments to determine their NC NOL. See Effect of Residency Status on Net Operating Losses for additional information.

Example: During 2025, a North Carolina resident Taxpayer operates a business as a sole proprietor and earns wages from a part-time job. Taxpayer is single and has the following income, deductions, and North Carolina adjustments on the North Carolina individual income tax return:

FEDERAL ADJUSTED GROSS INCOME	
Wages	52,000
North Carolina income tax refund	5,000
Capital loss	(2,000)
Net long-term capital loss on sale of stock	(3,000)
Net long-term capital gain on sale of business real estate	1,000
Net loss from business (Schedule C)	(151,000)
IRA contribution deduction	(2,000)
Adjusted Gross Income	**($100,000)**
NORTH CAROLINA ADDITIONS TO AGI	
Business Meal Deduction	5,000
Discharge of Certain Student Loan Debt	5,000
Total NC Additions	**$10,000**
NORTH CAROLINA DEDUCTIONS FROM AGI	
State tax refund	5,000
Ordinary and necessary business expense disallowed due to claiming a federal tax credit	10,000
Total NC Deductions	**$15,000**
North Carolina Standard Deduction	**$12,750**

Because Taxpayer's deductions for 2025 exceed Taxpayer's income, Taxpayer may have an NC NOL. Taxpayer must use Part 1 of Form NC-NOL to determine the amount of the NC NOL. Taxpayer completes Part 1 of Form NC-NOL and determines that the NC NOL incurred for 2025 is $105,000.

Part 1. Net Operating Loss Calculation				
1a.	Federal Adjusted Gross Income	(100,000)		
1b.	Additions to Federal Adjusted Gross Income	10,000		
1c.	Add Lines 1a and 1b		(90,000)	
1d.	Deductions from Federal Adjusted Gross Income	15,000		
1e.	N.C. Standard Deduction Amount or N.C. Itemized Deduction Amount	12,750		
1f.	Excess Business Loss Included as Other Income on your 2025 Federal Income Tax Return	0		
1g.	Add Lines 1d through 1f		27,750	
1.	Subtract Lines 1g from Line 1c			(117,750)
2.	Nonbusiness Capital Losses (Enter as a positive number)	3,000		
3.	Nonbusiness Capital Gains (Without regard to any IRC section 1202 exclusion)	0		
4.	If Line 2 is greater than Line 3, subtract Line 3 from Line 2 and enter the difference. Otherwise, enter zero		3,000	
5.	If Line 3 is greater than Line 2, subtract Line 2 from Line 3 and enter the difference. Otherwise, enter zero		0	
6.*	Nonbusiness Deductions (Enter as a positive number)	19,750		
7.**	Nonbusiness Income Other than Capital Gains	10,000		
8.	Add Line 5 and Line 7		10,000	
9.	If Line 6 is greater than Line 8, subtract Line 8 from Line 6 and enter the difference. Otherwise, enter zero			9,750
10.	If Line 8 is greater than Line 6, subtract Line 6 from Line 8 and enter the difference. Otherwise, enter zero (Amount cannot exceed the amount entered on Line 5)	0		
11.	Business Capital Losses Before Limitations	0		
12.	Business Capital Gains (Without regard to any IRC section 1202 exclusion)	1,000		
13.	Add Line 10 and Line 12		1,000	
14.	Subtract Line 13 from Line 11. (If zero or less, enter zero)		0	
15.	Add Line 4 and Line 14		3,000	
16a.	Enter the amount of your Net Short-Term Capital Gain (Loss)	0		
16b.	Enter the amount of your Net Long-Term Capital Gain (Loss)	(2,000)		
16c.	Add Lines 16a and 16b		(2,000)	
16.	Amount of Line 16c (Enter the amount as a positive number.)		2,000	
17.	IRC Section 1202 Exclusion from your 2025 Federal Income Tax Return			0
18.	Subtract Line 17 from Line 16. (If zero or less, enter zero)		2,000	
19.	Enter the smaller of Line 16 or $3,000, or if you filed your N.C. tax return married filing separately, enter the smaller of Line 16 or $1,500		2,000	
20.	If Line 18 is greater than Line 19, subtract Line 19 from Line 18 and enter the difference. Otherwise, enter zero.		0	
21.	If Line 19 is greater than Line 18, subtract Line 18 from Line 19 and enter the difference. Otherwise, enter zero.			0
22.	Subtract Line 20 from Line 15. (If zero or less, enter zero)			3,000
23.	N.C. NOL Deduction for Losses from Prior Years			0
24.	N.C. NOL (Add Lines 1, 9, 17, 21, 22, and 23. If the result is less than zero, enter the amount here. If the result is zero or more, you do not have an N.C. NOL.)			(105,000)

* Line 6 of Part 1 of Form NC-NOL is determined by adding the following:

NC Standard Deduction	$12,750
IRA Contribution Deduction	$2,000
NC deduction for refund included in AGI	$5,000
Total	**$19,750**

** Line 7 of Part 1 of Form NC-NOL is determined by adding the following;

NC Refund included in AGI	$5,000
NC Addition for Student Loan Discharge	$5,000
Total	**$10,000**

Reference: G.S. § 105-153.5A(a).

3. North Carolina Net Operating Loss Deduction

a. Overview

The NC NOL deduction is composed of two separate components:

- Federal Net Operating Loss Carryover ("Federal NOL Carryover")
- North Carolina Net Operating Loss Carryover ("NC NOL Carryover")

The Federal NOL Carryover consists of unabsorbed Federal NOL incurred before tax year 2022. The NC NOL Carryover consists of a NC NOL incurred beginning with tax year 2022.

G.S. § 105-153.5A(b) allows a deduction in the current taxable year for the NC NOL a taxpayer incurred in a prior taxable year, subject to the following limitations:

- The loss was incurred in one of the preceding 15 taxable years.
- Any loss carried forward is applied to the next succeeding taxable year before any portion of it is carried forward and applied to a subsequent taxable year.
- The taxpayer's NC NOL deduction may not exceed the amount of the taxpayer's North Carolina taxable income determined without deducting the taxpayer's NC NOL.
- The portion of the NC NOL attributable to the Federal NOL Carryover is only allowed to the extent described in subsection G.S. § 105-153.5A(f).

b. Federal Net Operating Loss Carryover

G.S. § 105-153.5A(f) provides that the portion of a taxpayer's Federal NOL Carryover that was not absorbed in a tax year beginning prior to January 1, 2022, may be included in the amount of a taxpayer's NC NOL in a tax year beginning on or after January 1, 2022. “Absorbed” means the amount of Federal NOL carried to a year less the amount of the Federal NOL carried forward from that year.

The Federal NOL Carryover is only allowed as a NC NOL in a tax year beginning after January 1, 2022, to the extent that the Federal NOL Carryover meets all of the following conditions:

- The Federal NOL would have been allowed in that tax year under section 172 of the Code as enacted on April 1, 2021.
- The provisions of G.S. § 105-153.5(c2)(8), (9), (10), (13), and (14) do not apply to the Federal NOL Carryover. These decoupling provisions are accounted for separately on the North Carolina return. For more information, see State Decoupling Provisions for NOLs Arising in 2018, 2019, and 2020 and 80% Limitation for NOLs arising during Tax Years 2018-2020.
- The Federal NOL was incurred in one of the preceding 15 taxable years.

Taxpayers will enter their allowable Federal NOL Carryover amount(s) in Part 2A of Form NC-NOL, Net Operating Loss Worksheet. Additional information is provided in the Instructions for Form NC-NOL.

Note: Nonresidents and part-year residents are required to make additional adjustments to determine their Federal NOL Carryover. See Effect of Residency Status on Net Operating Losses for additional information.

Reference: G.S. § 105-153.5A(f).

c. North Carolina Net Operating Loss Carryover

G.S. § 105-153.5A(b) allows a deduction in the current taxable year for the NC NOL a taxpayer incurred in a prior taxable year. Because an NC NOL could only be incurred beginning with tax year 2022, for tax year 2025 taxpayers will only be able to utilize a North Carolina NC NOL incurred in tax years 2022 through 2024.

Taxpayers must use Part 2B of Form NC-NOL, Net Operating Loss Worksheet, to determine the amount of their NC NOL Carryover that must be deducted in tax year 2025. Additional information about calculating the NC NOL Carryover is available in the Instructions for Form NC-NOL.

Reference: G.S. § 105-153.5A(b).

d. Calculating the NC NOL Deduction

Taxpayers must use Part 2 of Form NC-NOL, Net Operating Loss Worksheet, to determine the amount of their NC NOL deduction for tax year 2025. Taxpayers’ Federal NOL Carryover is calculated in Part 2A. Taxpayers’ NC NOL Carryover is calculated in Part

2B. Taxpayers use Part 2C to calculate the total NC NOL deduction for the year. Additional information about calculating the NC NOL is available in the Instructions for Form NC-NOL.

Example: *Taxpayer has been a North Carolina resident since 2010. For tax year 2025, Taxpayer's North Carolina taxable income, determined without regard to the NC NOL deduction, is $160,000. Taxpayer incurred a federal NOL for tax year 2012 of $100,000, $30,000 of which was absorbed as a NOL carryover in 2015. Taxpayer incurred a federal NOL for tax year 2016 of $50,000, none of which was absorbed by January 1, 2022. For tax year 2022, Taxpayer incurred a NC NOL of $100,000.*

Taxpayer will determine the NC NOL deduction for tax year 2025 by completing Part 2 of Form NC-NOL as follows.

- In Part 2A, Taxpayer enters the federal NOLs incurred and not absorbed by January 1, 2022, in Column A next to the applicable tax year. For tax year 2012, Taxpayer enters $70,000 on Column A, Line 3 (equal to the $100,000 2012 federal NOL minus the $30,000 absorbed in 2015). For tax year 2016, Taxpayer enters $50,000 in Column A, Line 7.

- In Part 2B, Taxpayer enters the NC NOL of $100,000 incurred in 2022 on Column A, Line 14.

- Taxpayer's maximum NC NOL deduction for 2025 is $160,000 because Taxpayer's NC NOL deduction cannot exceed Taxpayer's NC taxable income determined without regard to the NC NOL deduction. Beginning in Part 2A with the earliest tax year, Taxpayer includes in Column B the amounts in Column A until the total in Column B equals $160,000 or Taxpayer utilizes all amounts in Column A. Taxpayer will use the entire amount of the 2012 and 2016 Federal NOL Carryovers from Part 2A ($70,000 + $50,000 = $120,000) and Taxpayer will use $40,000 of the 2022 NC NOL Carryover.

- Taxpayer must include any remaining Federal or NC NOL Carryover amounts in Column C for use in later tax years. Taxpayer enters $0 in Part 2A, Column C, Lines 3 and 7, because Taxpayer fully utilized the 2012 and 2016 Federal NOL Carryovers in 2025. Because Taxpayer only used $40,000 of the $100,000 2022 NC NOL Carryover in 2025, Taxpayer enters $60,000 ($100,000-$40,000) in Part 2B, Column C, Line 14.

- Taxpayer enters the total Federal NOL Carryover and NC NOL Carryover on the applicable lines of Part 2C. Taxpayer's total NC NOL deduction for 2025 is $160,000.

Part 2A. Federal Net Operating Loss Carryover Deduction			
Tax Year	Column A Federal NOL Incurred and not Absorbed by January 1, 2022	Column B Federal NOL Carryover Deducted as N.C. NOL in Tax Year 2025	Column C Federal NOL Carryover Remaining (Column A minus Column B)
1. 2010			
2. 2011			
3. 2012	70,000	70,000	0
4. 2013			
5. 2014			
6. 2015			
7. 2016	50,000	50,000	0
8. 2017			
9. 2018			
10. 2019			
11. 2020			
12. 2021			
	13. Federal NOL Carryover Deduction	120,000	

Part 2B. North Carolina Net Operating Loss Carryover Deduction			
Tax Year	Column A N.C. NOL Carryover	Column B N.C. NOL Carryover Deducted as N.C. NOL in Tax Year 2025	Column C N.C. NOL Carryover Remaining (Column A minus Column B)
14. 2022	100,000	40,000	60,000
15. 2023			
16. 2024			
	17. NC NOL Carryover Deduction	40,000	

Part 2C. North Carolina Net Operating Loss Deduction	
18. Federal NOL Carryover Deduction Amount	120,000
19. N.C. NOL Carryover Deduction Amount	40,000
20. Total N.C. NOL Deduction	160,000

Reference: G.S. § 105-153.5A(b).

4. Effect of Residency Status on Net Operating Losses

a. Nonresident

In the year an NC NOL is created, a nonresident individual can only include income and deductions derived from a business carried on in North Carolina in the year of the loss. For more information, see the Instructions for Form NC-NOL.

In the year an NC NOL is deducted, the nonresident must include the NC NOL in the numerator of the fraction used to calculate taxable income as defined in G.S. § 105-153.4(b). For tax year 2025, this amount is determined in Part 2 of Form NC-NOL and entered on Line 28 in Column B of Form D-400 Schedule PN-1. **Note**: This amount should not exceed the total amount of North Carolina income determined without regard to the NOL deduction.

Example 1. *A nonresident Taxpayer incurs a federal NOL of $100,000 in 2019, $30,000 of which is from North Carolina sources. Taxpayer carries the federal NOL forward and none of the federal NOL is absorbed prior to January 1, 2022. Taxpayer has no other Federal or NC NOL Carryovers available in 2025. Taxpayer is a resident of North Carolina for tax year 2025. Taxpayer has North Carolina taxable income of $75,000 (determined without deducting any NC NOL) for tax year 2025.*

The Taxpayer will enter $30,000 on Part 2A, Line 10, Column A of Form NC-NOL because Taxpayer is allowed an NC NOL for tax year 2025 attributable to the 2019 Federal NOL Carryover from North Carolina sources. Because Taxpayer's North Carolina taxable income determined without regard to the NC NOL is greater than the amount of the Federal NOL Carryover, Taxpayer can deduct the entire Federal NOL Carryover in 2025 and will enter $30,000 on Part 2A, Line 10, Column B. Taxpayer will show $0 on Part 2A, Line 10, Column C of Form NC-NOL because Taxpayer has fully utilized the 2019 Federal NOL Carryover in tax year 2025.

Example 2. *A nonresident Taxpayer incurs a federal NOL of $100,000 in 2019, $80,000 of which is from North Carolina sources. Taxpayer carries the federal NOL forward and none of the federal NOL is absorbed prior to January 1, 2022. Taxpayer has no other Federal or NC NOL Carryovers available in 2025. Taxpayer is a nonresident of North Carolina for tax year 2025. Taxpayer has North Carolina income of $200,000 for 2025 (from Form D-400 Schedule PN, Line 21, Column B, determined without deducting any NC NOL).*

The Taxpayer will enter $80,000 on Part 2A, Line 10, Column A of Form NC-NOL because Taxpayer is allowed an NC NOL for tax year 2025 attributable to the 2019 Federal NOL Carryover from North Carolina sources. Because Taxpayer's North Carolina income determined without regard to the NC NOL is greater than the amount of the Federal NOL Carryover, Taxpayer will deduct the entire Federal NOL Carryover of $80,000 on Line 28, Columns A and B of Form D-400 Schedule PN-1 and will also include $80,000 on Part 2A, Line 10, Column B of Form NC-NOL. Taxpayer will enter $0 on Part 2A, Line 10, Column C of Form NC-NOL because Taxpayer has fully utilized the 2019 Federal NOL Carryover in tax year 2025.

Reference: G.S. § 105-153.5A(c).

b. Part-Year Resident

In a year an NC NOL is created, a part-year resident must include the income and deductions derived from a business carried on in North Carolina while the individual was a nonresident and the business income and deductions derived from all sources during the period the taxpayer was a resident. For more information, see the Instructions for Form NC-NOL.

In the year an NC NOL is deducted, a part-year resident must include the NC-NOL in the numerator of the fraction used to calculate taxable income as defined in G.S. § 105-153.4(c). For tax year 2025, this amount is determined in Part 2 of Form NC-NOL and entered on Line 28 in Column B of Form D-400 Schedule PN-1. **Note:** The amount determined in Part 2 of Form NC-NOL should not exceed the total amount of North Carolina income determined without regard to the NOL deduction.

Example. *Taxpayer was a part-year resident in 2020 and incurred a federal NOL of $100,000 in 2020. $20,000 of the 2020 federal NOL was from the Taxpayer's business in North Carolina while Taxpayer was a nonresident and $30,000 of the 2020 federal NOL was incurred while Taxpayer was a resident. Taxpayer carries the federal NOL forward and none of the federal NOL is absorbed prior to January 1, 2022. Taxpayer is a resident of North Carolina for tax year 2025. Taxpayer has North Carolina taxable income of $80,000 (determined without deducting any NC NOL) for tax year 2025.*

The Taxpayer will enter $50,000 on Part 2A, Line 11, Column A of Form NC-NOL, which includes $20,000 of the Federal NOL Carryover derived from North Carolina while Taxpayer was a nonresident and $30,000 of the Federal NOL Carryover derived from all sources while Taxpayer was a resident. Because Taxpayer's North Carolina taxable income determined without regard to the NC NOL is greater than the amount of the Federal NOL Carryover, Taxpayer can deduct the entire Federal NOL Carryover in 2025. Taxpayer will show $0 on Part 2A, Line 11, Column C of Form NC-NOL because Taxpayer has fully utilized the 2020 Federal NOL Carryover in tax year 2025.

Reference: G.S. § 105-153.5A(d).

5. Add Back Required for Federal Net Operating Losses

A taxpayer is required to add to AGI the amount of federal net operating loss deducted from AGI in calculating North Carolina taxable income.

Reference: G.S. § 105-153.5(c)(6).

6. Statute of Limitations and Recordkeeping

A taxpayer claiming an NC NOL must maintain and make available for inspection by the Secretary all records necessary to determine and verify the amount of the deduction. The Secretary or the taxpayer may redetermine an NC NOL originating in a taxable year that is closed under the statute of limitations for the purpose of determining the amount of loss that can be carried forward to a taxable year that remains open under the statute of limitations.

Reference: G.S. § 105-153.5A(e)

7. State Decoupling Provisions for NOLs Arising in 2018, 2019, and 2020

a. Background

Historically, federal NOLs could be carried back for up to two years and forward for up to twenty years. After the enactment of the Tax Cuts and Jobs Act of 2017 ("TCJA"), federal NOLs arising in tax years ending after 2017 could only be carried forward for most taxpayers. There was a limited exception that applied to certain farming losses. For federal NOLs arising in taxable years beginning after December 31, 2017, the TCJA generally limited the amount of the federal NOL deduction to 80% of taxable income.

The Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act") modified certain federal NOL provisions. In particular, the CARES Act allowed a five-year carryback for federal NOLs incurred in tax years 2018, 2019, and 2020. Furthermore, the CARES Act suspended the federal NOL carryforward deduction limitation until tax year 2021 for federal NOLs incurred during tax years 2018, 2019, and 2020. North Carolina law decoupled from these provisions of the CARES Act.

b. Federal NOL Carryback Incurred in Tax Years 2018, 2019, and 2020

The TCJA generally eliminated federal NOL carrybacks and permitted NOLs to be carried forward indefinitely. The CARES Act amended those rules temporarily by permitting federal NOLs incurred in 2018, 2019, and 2020 to be carried back for five years from the tax year of the loss, unless the individual elected to waive the carryback period. North Carolina chose not to adopt this provision of the CARES Act. Instead, for North Carolina tax purposes, an NOL incurred in 2018, 2019, and 2020 carried back for federal tax purposes must be added to AGI for tax years 2013 through 2019.

G.S. § 105-153.5(c2)(14) provides a deduction from AGI for the amount of federal NOL carryback deduction required to be added to AGI under G.S. § 105-153.5(c2)(8), (9), or (10). An individual may deduct 20% of the amount added to AGI in tax years 2013 through 2019 in each of the first five taxable years beginning on or after January 1, 2021.

c. Federal NOL Limit of 80% of Taxable Income Incurred in Tax Years 2018, 2019, and 2020

The TCJA amended section 172 of the Code to impose a new 80% NOL limitation starting with federal NOLs generated after January 1, 2018. Under the provisions of the TCJA, a taxpayer's federal NOL carryforward deduction was limited to 80% of federal taxable income without regard to the federal NOL deduction. This limitation was temporarily suspended by the CARES Act. North Carolina decoupled from the CARES Act suspension and, to the extent a taxpayer's federal NOL deduction exceeded the TCJA limitation, G.S. § 105-153.5(c2)(13) required the taxpayer to add back the amount of the deduction on the North Carolina return.

G.S. § 105-153.5(c2)(16) provides a deduction from AGI for the amount of the 80% NOL carryforward deduction limitation required to be added to AGI under G.S. § 105-153.5(c2)(13). An individual may deduct 20% of the amount added to an individual's AGI in tax years 2019 and 2020, in each of the first five taxable years beginning on or after January 1, 2021.

8. 80% Limitation for NOLs arising during Tax Years 2018 Through 2020

If a federal NOL carryforward was deducted in 2019 or 2020 for an NOL arising during 2018 or 2019, that carryforward for North Carolina purposes cannot exceed the amount allowed under the provisions of Code § 172 as enacted as of January 1, 2019 (i.e., the TCJA provisions). To the extent the federal NOL deduction exceeds the TCJA limitation, G.S. § 105-153.5(c2)(13) required the taxpayer to add back the amount of the deduction on the North Carolina return.

Under G.S. § 105-153.5(c2)(16), the amount added back to a taxpayer's AGI may be deducted in five equal installments beginning in tax year 2021. An installment, or portion of an installment, that is not utilized in a tax year cannot be carried forward to a subsequent tax year.

Example 1. *Taxpayer incurred a federal NOL of $100,000 in 2019. Taxpayer carries the NOL to the 2020 federal return. Taxpayer has $100,000 of federal taxable income in 2020 without regard to the NOL deduction. Under the CARES Act provisions, Taxpayer deducts the full amount of the federal NOL in 2020 and it is fully absorbed.*

An addition is required on the Taxpayer's 2020 North Carolina income tax return for the amount by which the Taxpayer's federal NOL deduction exceeded the amount allowed under provisions of Code § 172 as enacted as of January 1, 2019. In this case, Taxpayer will make an addition of $20,000 in tax year 2020 ($100,000 absorbed federal NOL carryforward deduction less $80,000 (80% of federal taxable income without regard to the NOL deduction)). Beginning in 2021, Taxpayer will be able to deduct $4,000 per year (20% of the addition) for five years.

Example 2. *Taxpayer incurred a federal NOL of $100,000 in 2019. Taxpayer carries the federal NOL to the 2020 federal return. Taxpayer has $60,000 of federal taxable income in 2020. Under the CARES Act provisions, Taxpayer deducts the full amount of the NOL in 2020 and has a $40,000 unabsorbed federal NOL carryforward.*

An addition is required on the Taxpayer's 2020 North Carolina income tax return for the amount by which the Taxpayer's federal NOL deduction exceeded the amount allowed under provisions of Code § 172 as enacted as of January 1, 2019. In this case, Taxpayer will make an addition of $12,000 ($60,000 absorbed federal NOL carryforward deduction less $48,000 (80% of federal taxable income without regard to the NOL deduction)) in tax year 2020. Beginning in 2021, Taxpayer will be able to deduct $2,400 per year (20% of the addition) for five years. Taxpayer must also make an addition in 2020 for the amount of unabsorbed NOL carryover, $40,000.

Reference: G.S. § 105-153.5(c2).

XXII. Taxed Pass-Through Entities

1. General

Several statutes within Article 4 of Chapter 105 were added or revised to allow S Corporations and certain partnerships ("PTEs") to elect to pay North Carolina income tax at the entity level (a "Taxed S Corporation," a "Taxed Partnership," or collectively a "Taxed PTE").

The income tax on the Taxed PTE is imposed at the individual income tax rate for the applicable taxable year. Each Owner of the Taxed PTE is allowed to deduct the Owner's share of the Taxed PTE's taxable income on the Owner's North Carolina income tax return ("NC Tax Return").

North Carolina law expressly provides that when a PTE elects to be a Taxed PTE, the State's income tax on the taxable income of the PTE is imposed on the PTE itself (and not the individual Owner). Under current federal law, a PTE that elects to pay state income tax at the entity level (as opposed to the Owner level) may generally deduct the amount of its state income tax as a business expense on the PTE's federal income tax return.

Reference: G.S. § 105-131.1; G.S. § 105-154.1.

2. Entities Eligible to Make the Taxed PTE Election

a. General

An eligible S Corporation required to file an North Carolina tax return under G.S. § 105-131.7 and an eligible partnership required to file an North Carolina tax return under G.S. § 105-154(c) can make the election to pay North Carolina income tax at the entity level (the "Taxed PTE Election"). An entity that is not a PTE is not eligible to make the Taxed PTE Election.

b. Eligible S Corporations

In North Carolina, an eligible S Corporation is an S Corporation as defined under North Carolina law. Any S Corporation for which a valid election under section 1362(a) of the Code is in effect can elect to make the Taxed PTE Election.

c. Eligible Partnerships

An eligible partnership is defined as a domestic partnership, a foreign partnership, or a limited liability company ("LLC") that is classified for federal income tax purposes as a partnership.

The following partnerships are **NOT** eligible to make the Taxed PTE Election:

- A publicly traded partnership that is described in section 7704(c) of the Code.
- A partnership that has at any time during the taxable year a partner who is not one of the following:

    1. An individual.
    2. An estate.
    3. Any of the following:
        a. A trust described in section 1361(c)(2) of the Code.
        b. A trust if such trust does not have as a beneficiary any person other than an individual, an estate, a trust, or an organization described in section 1361(c)(6) of the Code.
    4. An organization described in section 1361(c)(6) of the Code.
    5. A partnership, including an entity that is classified as a partnership for federal income tax purposes, or an entity that is classified as a corporation for federal income tax purposes.

Note: A partnership is eligible to make the Taxed PTE Election if a partner in the partnership is a single member LLC owned by an individual and the LLC is disregarded for federal income tax purposes. Such a partner's distributive share of income must be included in the taxable income of the Taxed Partnership.

Reference: G.S. § 105-131.1; G.S. § 105-154.1.

3. Making the Taxed PTE Election

An eligible PTE must make the Taxed PTE Election on its timely filed annual North Carolina tax return. The Taxed PTE Election is for the tax year covered by the return and is binding on all owners of the PTE. If a PTE does not answer "Yes" to the Taxed PTE question located on the front page of the North Carolina tax return, the PTE **DID NOT** make the Taxed PTE Election for the tax year.

The Taxed PTE Election must be made by the due date of the PTE's North Carolina tax return, including extensions. A Taxed PTE Election made on a late-filed North Carolina tax return is not valid. A PTE cannot make or revoke the Taxed PTE Election after the PTE's North Carolina income tax return is filed for the taxable year.

Example 1. *An eligible S Corporation filing a calendar year North Carolina tax return intends to make the Taxed S Corporation Election for tax year 2025. The S Corporation is granted an extension to file its North Carolina tax return. The S Corporation files the North Carolina tax return on or before October 15, 2026, and marks "Yes" to the Taxed S Corporation question located of the front page of the North Carolina tax return.*

The Taxed S Corporation Election is valid. The S Corporation is a Taxed S Corporation for tax year 2025.

Example 2. *An eligible partnership filing a calendar year North Carolina tax return intends to make the Taxed Partnership Election for tax year 2025. The partnership was not granted a federal extension or a North Carolina extension to file its 2025 partnership tax return. The partnership files the North Carolina tax return on October 15, 2026, and marks "Yes" to the Taxed Partnership question located of the front page of the North Carolina tax return.*

The Taxed Partnership Election is **NOT** valid because the Taxed Partnership Election cannot be made on a late-filed North Carolina tax return. The partnership is not a Taxed Partnership for tax year 2025.

Example 3. *An eligible partnership filing a calendar year North Carolina tax return intends to make the Taxed Partnership Election for tax year 2025. The partnership is granted an extension to file its North Carolina tax return. The partnership files the North Carolina tax return on June 15, 2026, but does not mark "Yes" to the Taxed Partnership question located of the front page of the North Carolina tax return.*

On October 1, 2026, the partnership files an amended North Carolina tax return and marks "Yes" to the Taxed Partnership question located on the front page of the tax return.

The Taxed Partnership Election is **NOT** valid because the Taxed Partnership Election cannot be made after the North Carolina tax return is filed. The partnership is not a Taxed Partnership for tax year 2025.

Example 4. *An eligible S Corporation filing a calendar year North Carolina return is granted an extension of time to file its North Carolina tax return for tax year 2025. On September 15, 2026, the S Corporation files a calendar year NC Tax Return and marks "No" to the Taxed S Corporation question located of the front page of the North Carolina tax return.*

On October 15, 2026, the S Corporation files an amended North Carolina tax return and marks "Yes" to the Taxed S Corporation question located on the front page of the tax return.

The Taxed S Corporation Election is **NOT** valid. The S Corporation is not a Taxed S Corporation for tax year 2025. The Taxed S Corporation Election cannot be made after the tax return is filed.

For more information, see Time and Place for Filing a Partnership Return and Time and Place for Filing an S Corporation Return.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

4. North Carolina Taxable Income

a. Overview

Taxed S Corporations

The North Carolina taxable income of a Taxed S Corporation is determined by adding each shareholder's pro rata share of the Taxed S Corporation's income or loss, subject to the adjustments provided in G.S. §§ 105-153.5 and 105-153.6, attributable to North Carolina. With respect to an S Corporation, income attributable to North Carlina is defined in G.S. § 105-131(b)(4).

Taxed Partnerships

The North Carolina taxable income of a Taxed Partnership is determined by adding each partner's distributive share of the Taxed Partnership's income or loss, subject to the adjustments provided in G.S. §§ 105-153.5 and 105-153.6, attributable to North Carolina. With respect to a partnership, income attributable to North Carolina includes all items of income, loss, deduction, or credit of the partnership apportioned and allocated to North Carolina pursuant to G.S. § 105-130.4.

Note: A Taxed Partnership with partners defined under G.S. § 105-154.1(a)(5) will **NOT** include those partners' distributive share of partnership income or loss in the Taxed Partnership's taxable income. Instead, the provisions of G.S. § 105-154(d) continue to apply with respect to those partners.

Example 1. *Partnership ABC has two partners, Partner A and Partner B. Partner A is a resident individual and Partner B is a resident C Corporation. Partnership ABC makes the election to be a Taxed Partnership for tax year 2025. Partner A's distributive share of Partnership ABC's income for 2025 is $750,000, and Partner B's distributive share of Partnership ABC's income for 2025 is $500,000.*

Partnership ABC will include Partner A's distributive share of income of $750,000 in the computation of North Carolina taxable income. Partnership ABC will not include Partner B's distributive share of income of $500,000 in the computation of North Carolina taxable income.

Example 2. *Partnership XYZ has two partners, Partner A and Partner B. Partner A is a resident individual and Partner B is a nonresident S Corporation. Partnership XYZ makes the election to be a Taxed Partnership for tax year 2025. Partner A's distributive share of Partnership XYZ's income for 2025 is $1,000,000, and Partner B's distributive share of Partnership XYZ's income for 2025 is $500,000. Partner B did not complete Form D-403 NC-NPA for 2025.*

Partnership XYZ will include Partner A's distributive share of income of $1,000,000 in the computation of North Carolina taxable income. Partnership XYZ will not include Partner

B's distributive share of income of $500,000 in the computation of North Carolina taxable income. Partnership XYZ will, however, be required to pay North Carolina income tax on behalf of Partner B under the provisions of G.S. § 105-154(d).

Example 3. *Partnership ABC has two partners, Partner A and Partner B. Partner A is a resident individual and Partner B is a nonresident S Corporation. Partnership ABC makes the election to be a Taxed Partnership for tax year 2025. Partner A's distributive share of partnership income for 2025 is $1,500,000, and Partner B's distributive share of partnership income for 2025 is $500,000. Partner B completed Form D-403 NC-NPA and Form NC-NPA was also filed with Partnership ABC's 2025 North Carolina tax return.*

Partnership ABC will include Partner A's distributive share of income of $1,500,000 in the computation of North Carolina taxable income. Partnership ABC will not include Partner B's distributive share of income of $500,000 in the computation of North Carolina taxable income. Moreover, Partnership ABC is not required to pay tax on behalf of nonresident Partner B under the provisions of G.S. § 105-154(d).

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

b. Items of Income or Loss

In general, an item is included in the calculation of North Carolina taxable income to the extent the item is included in the PTE's calculation of total income (loss). For tax year 2025, see federal Form 1120-S, Schedule K, Lines 1 through 10 or federal Form 1065, Schedule K, Lines 1 through 11.[2]

For more information on these items, see the instructions for filing the 2025 North Carolina S Corporation tax return or the North Carolina Partnership tax return.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

c. North Carolina Adjustments

1. Overview

Except as specifically excluded by statute, a Taxed PTE must include the North Carolina adjustments provided in G.S. §§ 105-153.5 and 105-153.6 when calculating North Carolina taxable income.

Important: Certain North Carolina adjustments provided in G.S. § 105-153.5 (including the standard deduction, itemized deductions, and child deduction) are not applicable to a PTE and are therefore not included in the calculation of North Carolina taxable income for a Taxed PTE. All applicable North Carolina adjustments, even

[2] The lines must reflect the amounts calculated under the Code.

adjustments included in the taxable income of the Taxed PTE, must be passed-through and reported to the Owners of the PTE.

Note: Form NC K-1 for an S Corporation and Form NC K-1 for a partnership are used to report each Owner's share of the PTE's income, adjustments, tax credits, etc**.** Form NC K-1 must be provided to each Owner on or before the day on which the North Carolina tax return is required to be filed.

2. Bonus Depreciation

A Taxed PTE must include the amount of bonus depreciation required pursuant to G.S. § 105-153.6(a) when calculating North Carolina taxable income. In addition, the Taxed PTE must notify the Owner of the amount of the bonus depreciation addback on Form NC K-1.

In general, a Taxed PTE may deduct the amount of bonus depreciation allowed under G.S. § 105-153.6(a) when calculating North Carolina taxable income.

Important: The deduction for bonus depreciation can only be passed to an Owner who was allocated the addition for bonus depreciation in the earlier tax year and the amount of the deduction in the current year is based on the amount of the addition made by the Owner in the earlier tax year. Consequently, a Taxed PTE can only deduct bonus depreciation for Owners who were Owners in the PTE in the year the bonus depreciation was added to the PTE's total income (or loss) and who are still Owners in the PTE in the year of the deduction.

For more information and examples regarding bonus depreciation, see North Carolina Decoupling Adjustments for Taxed PTE Owners.

3. Section 179 Expense

"Section 179 Expense" refers to the amount of depreciation expense a PTE is permitted to deduct for federal income tax purposes. The North Carolina adjustment required under G.S. § 105-153.6(c) for Section 179 Expense (including both the required addition and corresponding deduction) is not applicable when calculating the North Carolina taxable income of a PTE.

Note: If, for federal income tax purposes, a PTE has allocated a Section 179 Expense to an Owner, the PTE must provide a statement with the applicable Form NC K-1 that notifies the Owner that the North Carolina's dollar and investment limitation is different than the federal dollar and investment limitation and an addition to federal adjusted gross income may be required on the Owner's North Carolina individual income tax return. The Owner may file a North Carolina individual income tax return and deduct the Section 179 Expense, when applicable.

For more information and examples regarding decoupling adjustments, see North Carolina Decoupling Adjustments for Taxed PTE Owners.

4. Section 164 Expense

"Section 164 Expense" refers to the amount of state, local, or foreign income taxes a PTE is permitted to deduct for federal income tax purposes. A Taxed PTE must add the amount of Section 164 Expense deducted from federal taxable income when calculating North Carolina taxable pursuant to G.S. § 105-153.5(c1).

5. G.S. § 105-153.5(c3) Adjustments

The G.S. § 105-153.5(c3) Adjustments are not included when calculating the North Carolina taxable income of a Taxed Partnership.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1; G.S. § 105-153.5; G.S. § 105-153.6.

5. Estimated Income Tax

A Taxed PTE is generally required to make estimated income tax payments if the Taxed PTE reasonably expects to have a North Carolina income tax liability of at least five hundred dollars ($500). When applicable, the Taxed PTE is required to pay estimated tax payments in the same manner as a C corporation. The Taxed PTE must use one of the following vouchers to pay estimated income tax:

- Form CD-429 PTE, Taxed S Corporation Estimated Income Tax
- Form NC-40 PTE, Taxed Partnership Estimated Income Tax

A Taxed PTE required to pay estimated income tax generally must make estimated tax payments in four equal installments. The installments are generally due on or before the 15th day of the fourth, sixth, ninth and twelfth months of the taxable year (for calendar year filers, April 15, June 15, September 15, and December 15). If the due date of the payment falls on a weekend, federal, or State holiday, a payment postmarked by the day following the holiday or weekend is considered timely.

Note: The Department cannot transfer estimated tax payments made by an individual to a Taxed PTE.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1; G.S. § 105-163.39.

6. Underpayment of Estimated Income Tax Interest

A Taxed PTE that does not make the required estimated income tax payments is subject to interest for underpayment of estimated income tax.

Important: A Taxed PTE will not be subject to interest for underpayment of estimated income tax if the entity was not a Taxed PTE during the preceding tax year. In addition, the exceptions provided in G.S. § 105-163.41(d) for corporations apply to a Taxed PTE.

Example 1. *Partnership ABC filed a calendar year North Carolina tax return for tax year 2024 and did not make the election to be a Taxed Partnership. For tax year 2025, Partnership ABC did not make estimated income tax payments.*

On April 15, 2026, Partnership ABC files a calendar year North Carolina tax return for tax year 2025 and makes a valid Taxed Partnership Election. In addition, Partnership ABC pays $1,000, the tax shown due on the North Carolina tax return when the return is filed.

Even though Partnership ABC did not make estimated income tax payments for tax year 2025, Partnership ABC is not subject to interest on the underpayment of estimated income tax for tax year 2025 because Partnership ABC was not a Taxed Partnership for tax year 2024.

Example 2. *Partnership XYZ filed a calendar year North Carolina tax return for tax year 2024 and made the election to be a Taxed Partnership. For tax year 2025, Partnership XYZ did not make estimated income tax payments.*

On April 15, 2026, Partnership XYZ files a calendar year North Carolina tax return for tax year 2025 and does not make the election to be a Taxed Partnership. Partnership XYZ pays $1,500, the tax shown due on behalf of its nonresident individual partners when it files the return.

Even though Partnership XYZ was a Taxed Partnership for tax year 2024, Partnership XYZ is not subject to interest on the underpayment of estimated income tax for tax year 2025 because (1) Partnership XYZ did not make the election to be a Taxed Partnership for tax year 2025, and (2) Partnership XYZ is not required to pay estimated income tax for the tax due on behalf of its nonresident individual partners.

Example 3. *S Corporation ABC filed a calendar year North Carolina tax return for tax year 2024 and made the election to be a Taxed S Corporation. For tax year 2025, S Corporation ABC did not make estimated income tax payments.*

On April 15, 2026, S Corporation ABC files a calendar year North Carolina tax return for tax year 2025 and makes a valid Taxed S Corporation Election. S Corporation ABC pays $5,000, the tax shown due on the North Carolina tax return when the return is filed.

Unless an exception authorized under G.S. § 105-163.41 applies, S Corporation ABC is subject to interest on the underpayment of estimated income tax because S Corporation ABC was a Taxed S Corporation in tax year 2024 and its North Carolina income tax liability for tax year 2025 is at least five hundred dollars.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1; Article 4C.

7. Tax Due

a. Tax Rate

A Taxed PTE calculates its North Carolina income tax due by multiplying its North Carolina taxable income by the tax rate imposed on individuals who are required to file a North Carolina income tax return.

b. Payment of Tax

Apart from any required estimated tax payments, the full amount of tax shown due on the Taxed PTE's North Carolina income tax return must be paid within the time allowed for filing the return. An extension of time to file is not an extension of time to pay. The Taxed PTE will be subject to interest and the failure to pay penalty if it fails to pay the tax due by the original due date of the return.

If the Taxed PTE files a return showing an amount due with the return and does not pay the amount shown due, the Department may collect the tax from the Taxed PTE pursuant to G.S. § 105-241.22(1). The Department must issue a notice of collection for the amount of the tax debt to the Taxed PTE. If the tax debt (as defined in G.S.§ 105-243.1(a)) is not paid to the Secretary within 60 days of the date the notice of collection is mailed to the Taxed PTE, the Owners of the Taxed PTE are not allowed the deduction provided in G.S.§ 105-153.5(c3). If the disallowance results in additional tax due for the Owners, the Department will send the Owners a notice of proposed assessment in accordance with G.S. § 105-241.9.

Example 1. *S Corporation XYZ filed a calendar year North Carolina tax return for tax year 2024 and did not make the election to be a Taxed S Corporation. For tax year 2025, S Corporation XYZ did not make estimated income tax payments.*

On March 15, 2026, S Corporation XYZ is granted an extension of time to file its 2025 North Carolina income tax return. On October 15, 2026, S Corporation XYZ files a calendar year North Carolina tax return for tax year 2025 and makes a valid Taxed S Corporation Election. S Corporation XYZ pays $5,000, the full amount of income tax due on the North Carolina tax return when the return is filed.

Even though S Corporation XYZ did not make estimated income tax payments for tax year 2025, S Corporation XYZ is not subject to interest on the underpayment of estimated income tax because S Corporation XYZ was not a Taxed S Corporation for tax year 2024. However, the S Corporation will be subject to interest and the failure to pay penalty because it failed to pay the tax due by the original due date of the return.

c. Refunds

When a Taxed PTE files an North Carolina tax return reflecting an overpayment of tax due, the Department must refund the overpayment to the Taxed PTE within the provisions of

G.S. § 105-241.7. **Important:** Only the Taxed PTE, not its Owners, are entitled to request a refund of an overpayment made by the Taxed PTE. Moreover, the provisions of G.S. § 105-154(d) continue to apply to partners defined under G.S. § 105-154.1(a)(5); therefore, a Taxed Partnership **CANNOT** request a refund of an overpayment made on behalf of these partners.

For more information, see Statute of Limitations for Refunds.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

8. Reporting Requirements

In addition to the applicable federal and State reporting requirements for partnerships and S Corporations (e.g., each Owner's share of the PTE's income, adjustments, tax credits, etc.), a Taxed PTE must also report to its Owners the following information on Form NC K-1 for the applicable tax return:

- Whether or not the PTE made the Taxed PTE Election.
- The amount of the Owner's share of income or loss from the Taxed PTE to the extent it was included in the Taxed PTE's North Carolina taxable income.

For more information, see the instructions for the S Corporation Tax Return and the Partnership Tax Return.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

9. Tax Credits

a. North Carolina Income Tax Credits

A Taxed PTE that qualifies to claim an income tax credit may apply each Owner's share of the Taxed PTE's income tax credit against the Owner's share of the Taxed PTE's income tax.

Important: Only the Taxed PTE that qualified to claim the tax credit may take the tax credit (or any installment of the tax credit). The Taxed PTE **cannot** pass through to its Owners any tax credit for which the Taxed PTE qualified to claim, including any subsequent installment of such credit if the credit is required to be taken installments. In addition, only the Taxed PTE that qualified to claim the tax credit can take any unused portion of the tax credit carryforward to succeeding tax years.

Example 1. *Partnership ABC filed a calendar year North Carolina tax return for tax year 2025 and made the election to be a Taxed Partnership. During 2025, Partnership ABC was owned by resident and nonresident individuals.*

For tax year 2025, Partnership ABC qualified to claim an [Article 3L](#) income tax credit. On its 2025 tax return, Partnership ABC applied each partner's distributive share of tax credit against each partner's distributive share of Partnership ABC's North Carolina income tax. ***Note:*** *The Article 3L income tax credit was fully utilized in 2025.*

Because Partnership ABC (1) qualified for the Article 3L income tax credit in tax year 2024, and (2) elected to be a Taxed Partnership for tax year 2025, Partnership ABC **cannot** pass the Article 3L income tax credit through to its partners. Partnership ABC is permitted to apply each partner's distributive share of Article 3L income tax credit against that partner's distributive share of Partnership ABC's North Carolina income tax for tax year 2025.

Example 2: *Partnership XYZ filed a calendar year North Carolina tax return for tax year 2024 and made the election to be a Taxed Partnership. During 2024, Partnership ABC was owned by resident and nonresident individuals.*

For tax year 2024, Partnership XYZ qualified to claim an [Article 3L](#) income tax credit. On its 2024 tax return, Partnership XYZ applied each partner's distributive share of the Article 3L income tax credit against that partner's distributive share of Partnership's XYZ's North Carolina income tax. ***Note****: The amount of Article 3L tax credit Partnership XYX qualified for on its 2024 tax return exceeded Partnership XYZ's North Carolina income tax by $2,000,000.*

For tax year 2025, Partnership XYZ did not make the election to be a Taxed Partnership.

Because Partnership XYZ (1) qualified for the Article 3L income tax credit in tax year 2024, (2) elected to be a Taxed Partnership for tax year 2024, and (3) did not elect to be a Taxed Partnership for tax year 2025, Partnership XYZ **cannot** pass the Article 3L income tax credit carryforward through to its individual partners in tax year 2025. Moreover, the remaining $2,000,000 income tax carryforward can **only** be claimed by Partnership XYZ (i.e. applied to a partner's distributive share of Partnership's XYZ's North Carolina income tax) in a tax year that Partnership XYZ makes a valid Taxed Partnership Election.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

b. Tax Credit for Taxes Paid to Another State

The North Carolina taxable income of a Taxed PTE does not include a resident Owner's share of the Taxed PTE's income or loss not attributable to North Carolina. As such, a Taxed PTE is not entitled to a tax credit for taxes paid to another state on income not attributable to North Carolina.

For more information, see Owner Tax Credit for Taxes Paid to Another State,

Reference: G.S. § 105-131.1A; G.S. § 105-153.9; G.S. § 105-154.1.

10.Taxed PTE Owners

a. Income or Loss Attributable to North Carolina

The North Carolina taxable income of a Taxed PTE does not include a resident Owner's share of the Taxed PTE's income or loss not attributable to North Carolina. Consequently, the North Carolina taxable income of a Taxed PTE (and the Owner's corresponding deduction) only includes the Owner's share of income or loss attributable to North Carolina regardless of whether the Owner is a resident or nonresident.

An Owner of a Taxed PTE may deduct from adjusted gross income the amount of the taxpayer's share of income from the Taxed PTE to the extent it was included in the Taxed PTE's North Carolina taxable income and the taxpayer's adjusted gross income. For tax year 2025, a taxpayer that is an Owner in a Taxed PTE may claim the deduction on Form D-400 Schedule S.

A taxpayer that is an Owner of a Taxed PTE must add to adjusted gross income the amount of the taxpayer's share of loss from the Taxed PTE to the extent it was included in the Taxed PTE's North Carolina taxable income and the taxpayer's adjusted gross income. For tax year 2025, a taxpayer that is an Owner in a Taxed PTE must make the addition on Form D-400 Schedule S.

Reference: G.S. § 105-131.1A; G.S. § 105-153.5(c3); G.S. § 105-154.1.

b. Income or Loss not Attributable to North Carolina

Subdivisions (1a) and (3a) of G.S. § 105-153.5(c3) allow a deduction from AGI to a resident taxpayer who is an Owner of a PTE for the taxpayer's share of income not attributable to North Carolina from the PTE to the extent the income was:

1. Included in the PTE's taxable income in another state or the District of Columbia.

2. Subject to an entity-level tax levied on the aggregate share of the PTE's income allocable to one or more of its Owners.

3. Included in the taxpayer's AGI modified by North Carolina law.

Note: A PTE is taxable in another state or the District of Columbia if the PTE's business activity in that state or the District of Columbia subjects the PTE to a net income tax, or a tax measured by net income. In addition, the PTE does not have to make the election to be a Taxed PTE for North Carolina purposes in order for the PTE Owner to qualify for the

G.S. § 105-153.5(c3)(1a) or (3a) deduction. For tax year 2025, a resident taxpayer that is an Owner of a PTE may claim the deduction on Form D-400 Schedule S.

Reference: G.S. § 105-131.1A; G.S. § 105-153.5(c3); G.S. § 105-154.1.

c. Owner Deduction Disallowed for Taxed PTE's Failure to Comply with Statutory Requirements

North Carolina law requires a Taxed PTE to pay the full amount of North Carolina tax it owes. If the Taxed PTE does not pay the full amount of tax it owes, the Department must collect the tax due from the PTE. However, if the PTE does not pay the full amount of tax due within 60 days of being notified of the outstanding liability, the Owners of the PTE are not eligible to take a deduction for the Owners' share of income from the PTE. The Department will send each Owner of the PTE a Notice of Proposed Assessment for the tax year disallowing the deduction for the Owner's share of income from the PTE.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

d. North Carolina Decoupling Adjustments

Except as specifically excluded by statute, the adjustments provided in G.S. §§ 105-153.5 and 105-153.6 are included in the calculation of a Taxed PTE's North Carolina taxable income. The required North Carolina adjustments, even when included in the amount of taxable income calculated for the Taxed PTE, must also be passed-through and reported on the Owners' North Carolina tax returns.

A PTE Owner who makes a required North Carolina decoupling addition (e.g., for bonus depreciation) is entitled to the corresponding deduction in future tax years based on the addition made on the owner's North Carolina individual income tax return. A change in the Owner's percentage interest, Ownership status, or the Taxed PTE Election will not change the amount or timing of the deduction. An Owner who did not make the required North Carolina decoupling addition on their North Carolina individual income tax return is not entitled to the corresponding deduction.

Example 1. *Partner A is a partner in Partnership XYZ. Partnership XYZ made the election to be a Taxed Partnership. Partner A's distributive share of North Carolina income from Partnership XYZ is $1,000, which includes $800 of business income and a North Carolina addition of $200 to account for bonus depreciation deducted on the federal return. Taxed Partnership XYZ calculates and pays North Carolina tax on Partner A's $1,000 of income. Partner A is required to file a North Carolina tax return.*

Partner A's adjusted gross income includes the $800 of business income from Taxed Partnership XYZ. Partner A is required to add the $200 for bonus depreciation on Partner A's North Carolina tax return. Partner A is allowed to deduct $1,000 for the distributive share of income included in Taxed Partnership XYZ's North Carolina taxable income.

Example 2. *In tax year 2022, Partnership XYZ had two partners, Partner A and Partner B. Each partner's distributive share of partnership income included a North Carolina addition of $20,000 to account for bonus depreciation deducted on the federal return for tax year 2022. Partner C became a partner in Partnership XYZ during the 2023 tax year.*

Partnership XYZ made the election to be a Taxed Partnership for tax year 2025. Partners A, B, and C each have a distributive share of $50,000 in business income for tax year 2025.

Partnership XYZ will determine the portion of its North Carolina taxable income for Partners A and B by subtracting $4,000 (20% of the $20,000 bonus depreciation allocated to each partner in tax year 2020) from each partner's share business income of $50,000, for a total of $46,000 distributed to each partner. Because Partner C was not a partner in Partnership XYZ in the year of the bonus depreciation addition (tax year 2022), the deduction for bonus depreciation cannot be included in Partner C's distributive share of Partnership XYZ's North Carolina taxable income.

On Partner A's and Partner B's North Carolina individual income tax return, the $50,000 of partnership business income is included in each partner's adjusted gross income. Partner A and Partner B is allowed to deduct from adjusted gross income $4,000 for bonus depreciation (assuming each partner made the required addition for bonus depreciation on their individual income tax returns for tax year 2022). In addition, Partner A and Partner B are allowed to deduct from adjusted gross income $46,000, each Partner's share of Partnership XYZ's income taxed at the entity level.

On Partner C's North Carolina individual income tax return, the $50,000 of partnership business income is included in adjusted gross income. Partner C is allowed to deduct $50,000 from adjusted gross income, Partner C's share of Partnership XYZ's income taxed at the entity level. **Note:** Because Partner C did not have the requirement to make the addition for bonus depreciation in tax year 2022, Partner C is not entitled to deduct bonus depreciation in tax year 2025.

Reference: G.S. § 105-131.1A; G.S. § 105-153.5; G.S. § 105-154.1; G.S. § 105-153.6.

e. Estimated Income Tax

An Owner of a PTE must include the Owner's share of the PTE's North Carolina taxable income in the determination of whether the Owner is required to pay North Carolina estimated income tax for each year, unless the PTE does each of the following:

- Meets the statutory requirements to be a Taxed PTE in North Carolina for the tax year.
- Makes the Taxed PTE Election on its North Carolina tax return.

If the PTE does not meet both requirements, and the Owner does not include the Owner's share of the PTE's North Carolina income in Owner's determination of whether the Owner is required to pay estimated income tax, the Owner may owe interest on the underpayment of estimated income tax.

Note: The Owner of the PTE may be able to reduce or eliminate interest on the underpayment of estimated tax by using the annualized income installment method.

Important: Nonresident individual partners are not required to pay estimated income tax on their distributive share of a PTE's income.

For more information, see Estimated Income Tax and Interest on the Underpayment of Estimated Income Tax.

f. Nonresident Filing Requirements

1. Owners of Taxed S Corporations

   The North Carolina Administrative Code provides that "[a] nonresident shareholder in an S Corporation shall not be required to file a North Carolina individual income tax return when the only income from North Carolina sources is his or her share of S Corporation income and the S Corporation pays the tax on his or her behalf." This rule applies to nonresident shareholders of Taxed S Corporations to the extent the Taxed S Corporation complies with the provisions of G.S. § 105-131.1A.

   Reference: 17 NCAC 06B .4003.

2. Owners of Taxed Partnerships

   The North Carolina Administrative Code provides that "[a] nonresident individual partner is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the nonresident's share of income from a partnership doing business in North Carolina, and the manager of the partnership has reported the income of the nonresident partner, including any guaranteed payments made to the partner, and paid the tax due." This rule applies to nonresident partners of Taxed Partnerships to the extent the Taxed Partnership complies with the provisions of G.S. § 105-154.1.

   Reference: 17 NCAC 06B .3513.

g. North Carolina Tax Credits

A Taxed PTE **must** pass through to its Owners any tax credit required to be taken in installments if the first installment was taken in a tax year the Taxed PTE Election for the PTE was not in effect. For more information, see Tax Credits. Additional information is provided in the instructions for filing 2025 North Carolina Partnership and S Corporation North Carolina tax returns.

Reference: G.S. § 105-131.1A; G.S. § 105-154.1.

h. Tax Credit for Taxes Paid to Another State

The amount of resident Owners' income or loss included in a Taxed PTE's taxable income is limited to income or loss attributable to North Carolina. Accordingly, the Taxed PTE cannot claim a credit for taxes paid to another state on a resident's share of income not attributable to North Carolina because the Taxed PTE will no longer pay North Carolina tax on this income. See Income or Loss not Attributable to North Carolina for more information.

In addition, there is a deduction from AGI for resident taxpayer PTE Owners for the amount of the taxpayer's share of income not attributable to North Carolina from the PTE. Taxpayers who qualify for this deduction are not eligible for a tax credit under G.S. § 105-153.9 for any taxes paid on this income.

Reference: G.S. § 105-153.9.

XXIII. Taxable Status of Distributions from Regulated Investment Companies

1. General

Distributions from a regulated investment company ("mutual fund") other than "capital gain distributions" and "exempt interest dividends" are included in adjusted gross income in the same manner as distributions of other corporations. Distributions from earnings and profits are ordinary dividends (taxable dividends) unless the mutual fund notifies the taxpayer to the contrary.

Capital gain distributions are paid by mutual funds from their net realized long-term capital gains. Individuals receiving a capital gain distribution must report the distribution as a long-term capital gain on their federal income tax return.

Reference: 17 NCAC 06B .4101.

2. Exempt Interest Dividends

A mutual fund is qualified to pay exempt interest dividends only if at the close of each quarter of its taxable year at least 50% of the value of the total assets of the company consisted of state and local bonds, the interest from which is exempt from federal income tax, and certain other obligations on which the interest is exempt from federal income tax under provisions of federal law other than the Internal Revenue Code, as those provisions of the law were in effect on January 6, 1983. A mutual fund paying exempt interest dividends to its shareholders must send its shareholders a statement within 60 days after the close of the taxable year showing the amount of exempt interest dividends. The exempt interest dividends are not required to be included in adjusted gross income.

Exempt interest dividends paid by a mutual fund to a shareholder and not included in the shareholder's adjusted gross income shall be added to adjusted gross income to the extent it represents interest on obligations of states, other than North Carolina, and their political subdivisions. The total distribution designated as exempt interest dividends by a mutual fund shall be added to adjusted gross income in computing the shareholder's North Carolina taxable income unless the mutual fund provides a statement to the shareholder that designates the portion of the exempt interest dividends that represents interest from obligations of the State of North Carolina or its political subdivisions or the United States or its possessions.

3. Ordinary Dividends

Interest in the form of dividends from mutual funds is deductible from an individual's adjusted gross income to the extent the distributions represent interest on direct obligations of the United States Government. Interest earned on obligations that are merely backed or guaranteed by the United States Government do not qualify for the deduction. Further, this deduction does not apply to distributions that represent gain from the sale or other disposition of the securities nor to interest paid in connection with repurchase agreements issued by banks and savings and loan associations.

The taxpayer may not deduct mutual fund dividends on the basis of a percentage of investments held by the fund (i.e., a fund has 75% of its investments in United States Treasury Notes). The fund must furnish the shareholder a statement verifying the amount of interest paid to the shareholder that accrued from direct obligations of the United States Government. The statement to support the deduction must specify the amount of the dividend to the shareholder that represents interest on direct obligations of the United States Government.

This procedure will also apply with respect to interest on obligations of the State of North Carolina and any of its political subdivisions to the extent included in adjusted gross income.

Reference: 17 NCAC 06B .4103.

4. Capital Gain Distributions

The portion of distributions from a mutual fund that represents capital gain is reportable on the federal income tax return as capital gain income and not dividend income. Under G.S. § 105-153.5(b)(2), capital gain distributable to a shareholder who is a resident of North Carolina and attributable to the sale of an obligation issued before July 1, 1995, the profit from which is exempt by North Carolina statute, is deductible from federal adjusted gross income in determining the North Carolina taxable income of an individual, trust, or estate.

XXIV. Miscellaneous

1. Deposit of Payment

When a payment is received by the Department for less than the correct tax, penalty, and interest due under the law and the facts and the payment includes the statement, "paid in full" or other similar statements, the payment will be deposited as required by G.S. § 147-77. The endorsement and deposit of the payment with such statement will not make the statement binding on the Department and will not prevent the collection of the correct balance due pursuant to the provisions of G.S. § 105-241.22.

Reference: G.S. § 147-77.

2. Photograph, Photocopy, and Microphotocopy of Records

The Department is authorized by law to photograph, photocopy, or microphotocopy all records, including tax returns, and such copies, when certified by the Department as true and correct copies, shall be as admissible in evidence in all actions, proceedings, and matters as the original would have been.

Reference: G.S. § 8-45.3.

3. Setoff Debt Collection

In some cases, debts owed to certain State, local, and county agencies will be collected from an individual's income tax refund. If the agency files a claim with the Department for a debt of at least $50.00 and the refund is at least $50.00, the debt will be set off and paid from the refund. The Department will notify the debtor of the set-off and will refund any balance which may be due. The agency receiving the amount set-off will also notify the debtor and give the debtor an opportunity to contest the debt. If an individual has an outstanding federal income tax liability of at least $50.00, the Internal Revenue Service may claim the individual's North Carolina income tax refund. For more information, see G.S. § 105-241.7(e) and the Setoff Debt Collection Act of Chapter 105A of the North Carolina General Statutes.

Reference: Chapter 105A; G.S. § 105-241.7(e).

4. North Carolina Nongame and Endangered Wildlife Fund

An individual may elect to contribute all or any portion of an income tax refund (at least $1.00 or more) to the North Carolina Nongame and Endangered Wildlife Fund. Once the election is made to contribute, the election cannot be revoked after the return has been filed. The tax deductible contributions are essential to match private and federal grants to pay for conservation projects for sea turtles to songbirds, from native fish to bats. Conserving these species and their habitat is made possible by taxpayer contributions. If a taxpayer is not due a refund, the taxpayer may still contribute to the Fund by mailing a donation directly to the North

Carolina Wildlife Resources Commission, 1702 Mail Service Center, Raleigh, North Carolina 27699-1700. Checks may be made payable to the Nongame and Endangered Wildlife Fund.

Reference: G.S. § 105-269.5.

5. North Carolina Education Endowment Fund

A taxpayer entitled to a refund of income taxes, or a taxpayer who desires to make a contribution, may elect to contribute all or part of their refund or make a contribution to the North Carolina Education Endowment Fund established pursuant to G.S. § 115C-472.16 to be used in accordance with that statute. Once the election is made to contribute, the election cannot be revoked after the return is filed. Additional contributions to the fund may be made by mailing a donation directly to the North Carolina Department of Public Instruction, Cash Collections, 6336 Mail Service Center, Raleigh, North Carolina 27699-6336. Checks should be made payable to "North Carolina Department of Public Instruction" with an indication either on the check or in an attached note that it is a contribution for the NC Education Endowment Fund. For more information, see G.S. § 105-269.7.

Reference: G.S. § 105-269.7.

6. North Carolina's Breast and Cervical Cancer Control Program

An individual entitled to a refund of income taxes may elect to contribute all or part of the refund to the North Carolina Cancer Prevention and Control Branch of the Division of Public Health of the Department of Health and Human Services to be used for early detection of breast and cervical cancer. Once the election is made to contribute, the election cannot be revoked after the return has been filed. Refunds contributed shall be used only for early detection of breast and cervical cancer and shall be used in accordance with North Carolina's Breast and Cervical Cancer Control Program's ("NC BCCCP") policies and procedures. If you are not due a refund, you may still contribute to the NC BCCCP by mailing a donation directly to N.C. Cancer Prevention and Control Branch of the Division of Public Health of the Department of Health and Human Services, 1922 Mail Service Center, Raleigh, North Carolina 27699-1922. Checks should be made payable to "North Carolina Department of Health and Human Services" with an indication either on the check or in an attached note that it is a contribution for the N.C. Breast and Cervical Cancer Control Program Fund.

Reference: G.S. § 105-269.8.

7. Substantiating Documentation

Canceled checks, receipts, or other evidence to substantiate deductions on the tax return should be kept for a period of at least three years from the due date of the return or three years from the date the return is filed, whichever is later. Lack of adequate records could result in the disallowance of all or part of the deductions claimed. A canceled check, money order stub, or

Departmental receipt showing payment of tax should be kept for at least five years from the due date of the tax return.

Reference: G.S. § 105-251(a).

8. Report of Sale of Real Property by Nonresidents

Every individual, fiduciary, partnership, corporation, or unit of government buying real property located in North Carolina from a nonresident individual, partnership, estate or trust is required to complete Form NC-1099NRS, Report of Sale of Real Property by Nonresidents, reporting the seller's name, address, and social security number, or federal employer identification number; the location of the property; the date of closing; and the gross sales price of the real property and its associated tangible personal property. Within fifteen days of the closing date of the sale, the buyer must file the report with the Department of Revenue and furnish a copy of the report to the seller.

Reference: 17 NCAC 06B .3906.

9. Consumer Use Tax

North Carolina consumer use tax is due to be paid by individuals and businesses on the following items if the seller fails to collect the applicable sales tax:

1. Tangible personal property purchased, leased, or rented inside or outside this State for storage, use, or consumption in this State. This includes tangible personal property that becomes part of a building or another structure.

2. Certain digital property purchased inside or outside this State for storage, use, or consumption in this State.

3. Services sourced to this State.

For filing requirements and a list of common items on which sales and use tax may not have been collected and where use tax may be due by the purchaser, see the Department's Sales & Use Tax Bulletins.

Reference: G.S. § 105-164.6.

10. Tenancy by the Entirety

When filing separate returns, a determination must be made as to that portion of the income or loss from real property that must be reported by each spouse. Under G.S. § 39-13.6, a married couple has equal right to the control, use, possession, rents, income, and profit from real property held as tenants by the entirety and each spouse is taxed on one-half of the income or loss from such property located in North Carolina. When real property conveyed jointly in the name of a married couple is located in another state and the share of ownership of each is not fixed in the deed or other instrument creating the co-tenancy, each spouse is considered as having received one-half of the income or loss from the real property unless they can demonstrate that the laws of that particular state with respect to the right to the income from the property allocate the income or losses in a different manner.

Reference: 17 NCAC 06B .0119.

11. Community Property

If a two lawfully married individuals are domiciled in a state or country recognized for federal income tax purposes as a community property state or country and each spouse files a separate North Carolina individual income tax return with each spouse reporting one-half of the salary and wages received while domiciled in the community property state or country, each spouse shall claim one-half of the credit for the income tax withheld with respect to community wages. A schedule or statement must be attached to the North Carolina income tax return showing the name and social security number of each spouse, that they were domiciled in a community property state or country, and that 50 percent of each spouse's income tax withheld is allocated to the other spouse's North Carolina individual income tax return.

Reference: 17 NCAC 06B .0113.

12. Claim of Right Income Credit

A taxpayer who elects for federal tax purposes to take a federal tax credit in lieu of a tax deduction because the taxpayer was required to repay income under a Claim of Right may be entitled to a claim of right tax credit for North Carolina income tax purposes under G.S. § 105-266.2. For more information, see federal Publication 525.

If the taxpayer elects to take the federal tax credit instead of the tax deduction, the taxpayer is also considered to have made a payment of North Carolina income tax on the repayment. The payment, which is applied against the tax liability for the year in which the repayment was made, is the amount by which the tax was increased in the earlier year because the income was included in gross income minus the amount the tax for the current year was decreased because the repayment was deductible.

Note: Individuals may claim the payment on the individual income tax return by including the payment on the same line as S corporation payments.

Example: *In 2018, a single taxpayer reported North Carolina taxable income of $69,500 on which $3,822 in tax was paid. The taxpayer's only income was sales commissions. In 2019, it is determined that the commissions were erroneously computed for tax year 2018. Accordingly, the taxpayer pays back $25,000 of the commissions in 2019. Federal adjusted gross income for 2019 without regard to a deduction for the repayment is $10,000.* The taxpayer claims a credit on the 2019 federal return for the amount of tax paid in 2018 on the related income.

The tax payment to be claimed on the 2019 North Carolina return is determined as follows:

NC Tax on $69,500	$3,822
NC Tax on $44,500 ($69,500 - $25,000)	$2,447
Additional tax paid on $25,000 of commissions in 2018	$1,375
Less: Decrease in 2019 tax for deduction	$ 0
Payment to be claimed on the 2019 North Carolina Return. Enter amount on Form D-400, Line 21d, S Corporation.	$1,375

Form D-401 includes a "Repayment of Claim of Right Worksheet" for taxpayers who elect to take a tax deduction instead of a tax credit. See Claim of Right Income Deduction.

Reference: G.S. § 105-266.2.

XXV. Taxpayers' Bill of Rights

As a taxpayer, you are always entitled to fair, professional, prompt, and courteous service. Our goal is to apply the tax laws consistently and fairly so that your rights are protected and that you pay only your fair share of North Carolina tax. For more information, see North Carolina Taxpayers' Bill of Rights.