State of North Carolina

INDIVIDUAL INCOME TAX
PASS-THROUGH ENTITIES
WITHHOLDING BULLETIN

Reflecting Changes Made in the 2016 Regular Session
of the North Carolina General Assembly

Issued by:

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PREFACE

The Individual Income Tax, Pass-Through Entities, and Withholding Bulletin was prepared for the purpose of presenting the administrative interpretation and application of North Carolina income tax laws relating to individuals, partnerships, estates, and 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administrative rule, or new case law subsequent to the date of this publication, the provisions in this bulletin may be superseded or voided. Unless otherwise noted, this bulletin is intended to reflect changes made in the **2016 Regular Session** of the North Carolina General Assembly.

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I. Subject: Filing Individual Income Tax Returns

1. Forms (17 NCAC 01C .0322)

The individual income tax return, "Form D-400," and supporting schedules can be obtained by clicking "Individual Income Tax Forms and Instructions." The return can also be obtained from the main office in Raleigh or from any of the Department's Service Centers located throughout the State. See "Office Locations" for locations and hours.

2. Electronic Tax Filing (eFile) (17 NCAC 01C .0701)

The North Carolina Department of Revenue participates in the Federal/State eFile program, the fastest, safest, and most accurate way to file individual income tax returns. The eFile program, the number one Department-recommended method for filing and paying income taxes, allows residents, nonresidents, and part-year residents to file their federal and State tax returns in a single electronic transmission, or to file their State returns separately in a single transmission. It also allows direct deposit for tax refunds (checking or savings accounts only); filing of estimated tax, extensions, and bank payments; and features acknowledgment and confirmation of receipt of tax forms.

Tax practitioners and taxpayers must eFile using Internal Revenue Service (IRS)-approved and Department-approved, commercially developed, software products; please visit "eFile for Individuals" to access a list of approved software developers and products. Using approved software, taxpayers can self-prepare their federal and State returns using eFile for a Fee, eFile for Free (for those who qualify), or using the services of a professional tax practitioner. Qualifications for eFile for Free and availability of functionality for estimated tax, extensions, and payments vary by software developer; therefore, tax practitioners and taxpayers should confirm product availability when selecting a developer. Regardless of selected developer, eFile for Free must be accessed from the Department's website.

To participate in the Federal/State eFile program, a tax practitioner must have previously completed an IRS Form 8633, "Application to Participate in the eFile Program." To participate in State eFile, the practitioner must have been accepted into the Federal program and have received an Electronic Filing Identification Number (EFIN) from the IRS. The Department has access to the Federal Applicant Database that enables the Department to reference pertinent information regarding the tax practitioner.

3. Items Requiring Special Attention (17 NCAC 06B .0102) (17 NCAC 06B .0104) (17 NCAC 01C .0322)

The individual taxpayer or his agent should give special attention to the following items when preparing an individual income tax return:

a. When filing an income tax return, the proper tax year must be used. For example, a 2016 form must be used by a taxpayer whose calendar year ends December 31, 2016. A taxpayer filing on a fiscal year basis whose fiscal year begins in 2016 must also use a 2016 form.

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

c. When filing an income tax return for an unmarried individual who died during the taxable year, enter the date of death in the applicable box.

d. When filing a separate return of a decedent who was married at the time of death, enter the date of death in the applicable box and enter the address of the surviving spouse or personal representative.

e. The taxpayer is required to furnish his 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.

f. The filing status claimed on the federal return must also be claimed on the North Carolina income tax return. However, for a married couple, if either the taxpayer or the taxpayer's spouse is a nonresident and had no North Carolina taxable income for the taxable year, the filing status married filing separately may be claimed. Once a joint return is filed, separate returns may not be filed for that year after the due date of the return.

g. The tax must be computed accurately and any penalty and interest prescribed by statute should be included on the return.

h. 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, click "eServices 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.

i. 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 lines 24 through 26 on "Form D-400 Schedule S, Part D," Computation of North Carolina Taxable Income for Part-Year Residents and Nonresidents. 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 Tax Paid to another State or Country."

j. 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.

k. 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.

l. 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.

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

n. 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.

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

p. A taxpayer and the taxpayer's spouse, if filing a joint return, can voluntarily indicate whether the taxpayer and the taxpayer's spouse are veterans by filling in the appropriate circle on "Form D-400."

4. Substitute Returns (17 NCAC 01C .0601)

Any facsimile or substitute form must be approved by the Department prior to its use. The guidelines for producing substitute forms are available in the publication, "Requirements for the Approval of Substitute Tax Forms". An electronic copy of the publication may be obtained by making a request to the "Vendor Support Unit" at "allaboutforms@ncdor.gov" or by calling (919) 754-2625.

If you use computer generated returns, the software company is responsible for requesting and receiving an assigned software developer identification. To see a list of approved software developers, click "List of Approved Tax Forms of Software Developers". Photocopies of the return are not acceptable. 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.

5. Federal Forms (17 NCAC 06B .0106)

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

6. Extensions (17 NCAC 06B .0107)

If you are unable to file your North Carolina Individual Income Tax Return, "D-400," by the due date of the return, you may apply for a six-month (6) extension. The due date of the individual income tax return for calendar year taxpayers is April 15th. For taxpayers 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.

To receive an extension of time, you must file "Form D-410," Extension for Filing Individual Income Tax Return, by the due date of the return. **North Carolina does not accept any federal extension forms in lieu of the North Carolina extension form.** Without a valid extension, an individual income tax return filed after the statutory 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 with the extension request. 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, you will owe applicable penalties and interest.

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 in order to minimize any penalties and interest due. You must also file 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.

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 (4) 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 (4) extension period, an additional two-month (2) extension may be obtained by filling

in the circle at the bottom right of_Form D-410. To receive the additional two month (2) extension, "Form D-410" must be filed by August 15.

You can apply for an extension and pay your 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 list of approved eFile vendors**). 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 (no access to federal filing and paying).

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, click "here" to create a personalized D-410. You may also pick up an extension form at one of our "Service Centers" or call the Department at 1-877-252-3052. An extension form can also be ordered from the Department. (Click here.)

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." You can also watch a video on how to apply for an extension. (Click "here" to watch the video.)

7. Amended Returns

Individuals who need to amend their **2016** tax return, complete and file both (1) "Form D-400" and fill in the applicable circle and (2) "Form D-400 Schedule AM," 2016 North Carolina Amended Schedule, and any applicable schedules (i.e. "Form D-400, Schedule S", Form D-400TC, etc.).

For tax year 2015, complete and file that year's "Form D-400," "Form D-400, Schedule AM," and any applicable schedules.

For tax years 2012, 2013, and 2014, use the appropriate tax year Form D-400X for filing an amended return.

For tax years 2009 through 2011, complete a corrected Form D-400, "Individual Income Tax Return," with the amended indicator filled in for the tax year they are amending. Individuals must also complete Form D-400X-WS, "Worksheet for Amending Individual Income Tax Return," and attach it to the front of the corrected Form D-400, "Individual Income Tax Return." Do not send a copy of the original return.

For tax years 2008 and prior, use Form D-400X, "Amended North Carolina Individual Income Tax Return."

Generally, amended returns on which you owe additional tax are required to be filed and the tax paid within three years after the date on which the original return was filed or within three years from the date required by law for filing the return, whichever is later. Amended returns requesting a refund must be filed within the "statute of limitations for refunds."

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. If an individual does not amend the State return to reflect the federal changes and the Department of Revenue 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. § 105-241.7," "G.S. § 105-241.8," " G.S. § 105-241.9," and the "Department's Important Notice dated July 13, 2016."

8. Tax Rate (G.S. § 105-153.7)

The individual income tax rate is 5.75% for tax years beginning on or after January 1, 2015 and before January 1, 2017. The tax rate is 5.499% for tax years beginning on or after January 1, 2017. For more information, see "Tax Rates."

9. Time and Place for Filing (G.S. § 105-155)

The due date for filing a calendar year end individual income tax return is generally April 15 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 on or before the 15th day of the fourth month following the close of the fiscal year. For information on when a document is considered timely filed, see "Departmental Directive TA-16-1."

II. Subject: Filing Requirements (G.S. § 105-153.8) (17 NCAC 06B .0109)

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 has its own standard deduction and does not allow a deduction for personal or dependent exemptions.

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

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

a. Every resident of North Carolina whose income for the taxable year exceeds the amount for the individual's filing status in the chart on the next page.

b. Every part-year resident who received income while a resident of North Carolina or who received income while a nonresident attributable to the ownership of any interest in real or tangible personal property in North Carolina or derived from a business, trade, profession, or occupation carried on in North Carolina, or derived from gambling activities in North Carolina and whose total income for the taxable year exceeds the amount for the individual's filing status in the chart on the next page.

c. Every nonresident who received income for the taxable year from North Carolina sources that was attributable to the ownership of any interest in real or tangible personal property in North Carolina or derived from a business, trade, profession, or occupation carried on in North Carolina, or derived from gambling activities in North Carolina and whose total income for the taxable year exceeds the amount for the individual's filing status in the chart on the next page.

3. Minimum Gross Income Filing Requirements

If an individual was not required to file a federal income tax return but had gross income inside and outside North Carolina that exceeds the amount for the individual's filing status shown in the chart on the next page, a federal return must be completed and attached to the North Carolina return to show how the federal adjusted gross income, deductions, and exemptions were determined.

A Return is Required if Federal Filing Status is	and Gross Income Exceeds
(1) Single	$ 8,250
(2) Married - Filing Joint Return	$ 16,500
(3) Married - Filing Separate Return	$ 8,250
If spouse does not claim itemized deductions	$ 8,250
If spouse claims itemized deductions	0
(4) Head of Household	$ 13,200
(5) Qualifying widow(er) with dependent child (surviving spouse)	$ 16,500
(6) Nonresident alien	$ 0

4. Joint Returns (G.S. § 105-153.8(e)) (17 NCAC 06B .0112)

"G.S. § 105-153.8(e)" requires a married couple to file a joint State income tax return if:

a. They file a joint federal income tax return, and

b. Both spouses are residents of North Carolina or both spouses had North Carolina taxable income.

Generally, all other individuals must file separate returns.

On joint returns, both spouses are jointly and severally liable for the tax due. However, a spouse will be allowed relief from a joint State income tax liability attributable to a substantial understatement by the other spouse if the spouse qualifies for innocent spouse relief of liability for federal tax attributable to the same substantial understatement by the other spouse under Internal Revenue Code Section 6015.

A married couple who files a joint federal income tax return may file a joint State return even if one spouse is a nonresident and had no North Carolina income. However, the spouse required to file a North Carolina return has the option of filing the State return as married filing separately. Once a married couple files a joint return, they cannot choose to file separate returns for that year after the due date of the return. If an individual chooses to file a separate North Carolina return, the individual must complete either a federal return as married filing separately reporting only his or her income and deductions, or a schedule showing the computation of his or her separate income and deductions and attach it to the North Carolina return.

Itemized nonbusiness deductions of a married couple may be claimed by a spouse only if that spouse 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 spouse who actually paid the item. In addition, a copy of the complete joint federal return must be included unless the federal return reflects a North Carolina address.

III. Subject: Computation of North Carolina Taxable Income ((G.S. § 105-153.4) (G.S. § 105-153.5) (G.S § 105-153.6) (17 NCAC 06B.0014)

1. General

The starting point for determining North Carolina taxable income is federal adjusted gross income, subject to the following additions and deductions and North Carolina standard deduction or North Carolina itemized deductions. Individuals should determine which adjustments apply to their returns.

2. Additions to Federal Adjusted Gross Income (G.S. § 105-153.5) (G.S. § 105-153.6)

Federal adjusted gross income must be increased by the following additions to the extent the amounts are not included in federal adjusted gross income:

1. Interest received upon 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 and their political subdivisions other than North Carolina. For more information, see "Taxable Status of Distributions from Regulated Investment Companies."

2. 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 his 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.

3. The amount by which the basis of property for federal purposes exceeds the basis for State purposes upon disposition of the property.

4. The amount of domestic production activities income deducted under Code section 199 in determining federal adjusted gross income.

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

    a. Federal Accelerated (Bonus) Depreciation

    Taxpayers are 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.

For most tax years prior to 2016, a percentage of the federal bonus depreciation allowed under sections 168(k) and (n) of the Code was required as an add-back to federal taxable income or adjusted gross income, as appropriate. If an addition was required, a 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," and "Adjustment for Bonus Depreciation."

b. Section 179 Expensing Limitations

Beginning with tax year 2010, North Carolina did 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, as follows:

Tax Year	**NC Dollar Limitation**	**NC Investment Limitation**
2010	$250,000	$800,000
2011	$250,000	$800,000
2012	$250,000	$800,000
2013 and forward	$ 25,000	$200,000

In addition, taxpayers placing section 179 property in service during these years are required to add to federal taxable income or federal adjusted gross income, whichever is applicable, 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, taxpayers 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."

6. The amount of net operating loss carried to and deducted in arriving at adjusted gross income on the federal return but not absorbed in that year and carried forward to a subsequent year.

7. 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 higher education expenses of the designated beneficiary. The addition is not required if the withdrawal was made without penalty under section 529 of the Code due to the death or permanent disability of the beneficiary.

8. North Carolina does not conform to the federal provision that allows a taxpayer to exclude from gross income cancellation of debt income from the discharge of qualified principal residence indebtedness. Instead, a taxpayer is required to make an addition to adjusted gross income under "G.S. § 105-153.5(c2)(1)" for the amount of indebtedness excluded for federal purposes. If the taxpayer whose qualified principal residence indebtedness is discharged is insolvent as defined in section 108(d)(3) of the Code, the addition is limited to the amount of discharge of qualified principal residence indebtedness excluded from income that exceeds the amount of discharge of indebtedness that would have been excluded because the taxpayer was insolvent.

9. North Carolina does not conform to the federal provision that allows a taxpayer to deduct in arriving at federal adjusted gross income qualified tuition and related expenses. Instead, a taxpayer is required to make an addition to adjusted gross income under "G.S. § 105-153.5(c2)(2)" for the amount of qualified tuition and related expenses excluded for federal purposes.

10. North Carolina does not conform to the federal provision that allows a taxpayer who has attained age 70 ½ to exclude from gross income the amount of a qualified charitable distribution from an individual retirement plan in lieu of claiming a charitable contribution deduction for the distribution. Instead, the taxpayer is required to make an addition to adjusted gross income under "G.S. § 105-153.5(c2)(3)" for the amount of the distribution excluded for federal purposes.

    Note: If an addition is required, the taxpayer may deduct the contribution amount added to adjusted gross income as a North Carolina itemized deduction if the taxpayer claims federal itemized deductions.

3. Deductions from Federal Adjusted Gross Income (G.S. § 105-153.5) (G.S. § 105-153.6) (17 NCAC 06B .0116)

Federal adjusted gross income may be decreased by the following deductions to the extent the amounts are included in federal adjusted gross income:

1. Interest upon the obligations of any of the following:

    a. 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."

   b. Interest on bonds, notes, and other obligations of the State of North Carolina or any of its political subdivisions. For more information, including examples, see "Income from North Carolina Obligations."

   c. Interest on obligations of a nonprofit educational institution organized or chartered under North Carolina law.

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

2. 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.).

3. 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;

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

5. 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.

6. The amount by which the basis of property for State purposes exceeds the basis for federal purposes upon disposition of the property. The deduction can be claimed only in the year in which the property is disposed. (See "Bonus Asset Basis".)

7. 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. (See "Bailey Settlement.")

8. The amount allowed as a deduction under "G.S. § 105-153.6" as a result of an addition for federal accelerated depreciation and expensing. (See "Bonus Asset Basis")

   a. An amount equal to 20% of the bonus depreciation deduction added to federal taxable income or federal adjusted gross income on the 2011, 2012, 2013, 2014, and 2015 State returns. For more information, see "Adjustment for Bonus Depreciation."

   b. An amount equal to 20% of the section 179 expense deduction added to federal taxable income or federal adjusted gross income on the 2011, 2012, 2013, 2014, and 2015 State

returns. For more information, see, "Income Tax Adjustments for Code Section 179 Expense."

9. The amount of income realized from the reacquisition of a debt instrument in tax years 2009 and 2010 that the taxpayer elected to defer the inclusion of in adjusted gross income until tax year 2014. Such income deferred until tax year 2014 was required to be included in gross income ratably over a five-year period. This deduction prevents the double taxation of that income because North Carolina did not recognize the deferral and taxed the income in the year of reacquisition.

10. 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 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.

4. North Carolina Standard Deduction (G.S. § 105-153.5(a)(1))

In calculating North Carolina taxable income, an individual may deduct from adjusted gross income either the North Carolina standard deduction or the North Carolina itemized deduction amount that was claimed under the Code. It is important to note that the North Carolina standard deduction is greater than the federal standard deduction for most taxpayers.

The standard deduction for most individuals for tax year 2016 can be found in the chart located below. However, the standard deduction is zero for persons who are not eligible for the standard deduction under section 63 of the Code.

N.C. Standard Deduction Chart

If your filing status is:	Your standard deduction is:
Single	$ 8,250
Married filing jointly/Qualifying widow(er)/ (surviving spouse)	$ 16,500
Married filing separately	
If spouse does not claim itemized deductions	$ 8,250
If spouse claims itemized deductions	0
Head of household	$ 13,200

Important. For tax year 2017, the standard deduction will increase for each filing status. For a single taxpayer, the standard deduction will increase to $8,750. For a married couple filing jointly, the standard deduction will increase to $17,500. For a qualifying window(er) with a dependent child (surviving spouse), the standard deduction will increase to $17,500. For a married person filing separately (if the spouse does not claim itemized deductions), the

standard deduction will increase to $8,750. For a taxpayer filing as head of household, the standard deduction will increase to $14,000.

5. North Carolina Itemized Deductions (G.S. § 105-153.5(a)(2))

North Carolina itemized deductions are not identical to federal itemized deductions and are subject to certain limitations. Specifically, no itemized deductions included on federal Form 1040 Schedule A are allowed as North Carolina itemized deductions except qualified mortgage interest, real estate property taxes, charitable contributions, medical and dental expenses, and repayment of claim of right income. In addition, North Carolina itemized deductions are not subject to the overall limitation on itemized deductions under section 68 of the Code.

Important. Individuals must complete "Form D-400 Schedule S, Part C," N.C. Itemized Deductions, and attach the schedule to "Form D-400" if a N.C. itemized deduction is claimed.

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, respectively, 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.

   North Carolina does not conform to the federal provision that allows a taxpayer to treat mortgage insurance premiums as qualified residence interest. Instead, a taxpayer is required under "G.S. § 105-153.5(a)(2)b" to exclude the amount of mortgage insurance premiums from the amount of qualified residence interest claimed as a North Carolina itemized deduction.

b. **Charitable Contributions.** Charitable contributions allowed as a deduction under section 170 of the Code are allowed. A taxpayer who is required to make an addition to federal adjusted gross income under "G.S. § 105-153.5(c2)(3)" for the amount of a qualified charitable distribution from an individual retirement plan is allowed under "G.S. § 105-153.5(a)(2)a" to include the amount of distribution as part of the taxpayer's charitable contribution deduction when claiming North Carolina itemized deductions if the taxpayer itemizes deductions on his or her federal return.

c. **Medical and Dental Expenses.** Medical and dental expenses allowed as a deduction under section 213 of the Code, from Line 4 of Schedule A, Federal Form 1040, are allowed as a North Carolina itemized deduction.

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 (i) 2% of adjusted gross income minus (ii) all other federal miscellaneous itemized deductions subject to the 2% limitation.

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 Code section 1341(a)(5). In that case, a taxpayer will recover the tax previously paid on the repaid income under "G.S. § 105-266.2". For more information on the claim of right credit, see "Claim of Right Credit."

IV. Subject: Bonus Asset Basis (G.S. § 105-153.6(e))

1. General

Effective for tax years beginning on or after January 1, 2013, 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.

2. Definitions

a. **Transferor.** An individual, partnership, corporation, S Corporation, limited liability company, or an estate or trust that does not fully distribute income to its beneficiaries.

b. **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.

c. **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.

For more information, see "Bonus Asset Basis."

4. Examples

For tax years 2002 through 2004 and 2008 through 2016, 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 2011 North Carolina return for 85% of the bonus depreciation deducted on the 2011 federal return. The taxpayer may then deduct 20% of the amount of the addition on each of the taxpayer's 2012 through 2016 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, 2013 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, 2016, 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 2013 through 2015 are as shown below.

Taxpayer A (Transferor)	**2013**	**2014**	**2015**
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 2015.

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 -	$100,000
Less: Taxpayer A's Federal Depreciation -	(100,000)
Plus: State Bonus Depreciation Addition -	85,000
Less: State Bonus Depreciation Deductions -	(34,000)
State Bonus Asset Basis as of January 1, 2016	**$ 51,000**

Taxpayer B's depreciation, basis, and State Bonus Asset Basis deductions for 2016 are as shown below.

Taxpayer B (Transferee)	2016
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 2016, 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 2016.

Example 2. Taxpayer C purchased property on January 1, 2013, 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, 2015, 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 2013 through 2014 are as shown below.

Taxpayer C (Transferor)	2013	2014
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 2014.

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 -	$100,000
Less: Taxpayer C's Federal Depreciation -	(100,000)
Plus: State Bonus Depreciation Addition -	85,000
Less: State Bonus Depreciation Deductions -	(17,000)
State Bonus Asset Basis as of January 1, 2015	**$ 68,000**

Taxpayer D (Transferee)	2015	2016	2017
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 2015 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 2017.

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.

V. Subject: 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, 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 (Internal Revenue 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 his or her contributions to the retirement system. If the employee withdrew his or her 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 of 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. Benefits from Other Retirement Plans

Effective for taxable years beginning on or after January 1, 2014, there is no deductions available for distributions from private retirement plans or government retirement plans that do not qualify as tax-exempt *Bailey* benefits.

VI. Subject: Net Operating Losses

1. General

Prior to 1989, North Carolina law provided a measure of relief to individual income taxpayers who incurred economic misfortune by allowing losses qualifying as net economic losses (NELs) as defined by G.S. § 105-147(9)(d)(2) to be carried forward and deducted from future gross income. With the adoption of federal taxable income as the starting point in determining North Carolina taxable income in 1989, net operating losses (NOLs) were recognized for State individual income tax purposes. The primary differences between NOLs and NELs are (1) nontaxable income is used to reduce the amount of an NEL but is not used to reduce the amount of NOL, and (2) NELs can only be carried forward while NOLs can be carried back and/or forward.

The American Recovery and Reinvestment Act of 2009 (ARRA) amended Internal Revenue Code Section 172(b)(1)(H) to allow an Eligible Small Business (ESB) to elect to carry back a 2008 NOL for a period of three, four, or five years rather than the standard two years (ARRA election). An ESB is defined in Internal Revenue Code Section 172(b)(1)(H).

The Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA) modified the ARRA by allowing businesses of every size to carry back 2008 or 2009 NOLs for up to five years preceding the taxable year of the NOL, but with a 50% of federal taxable income limit on NOL offsets in the fifth year, and 100% of all income in the remaining four carry back years. The election may be made in either 2008 or 2009, but not both years. However, a taxpayer who incurs an NOL from an ESB and makes an ARRA election for 2008 may also make a WHBAA election for 2009.

Beginning with tax year 2012, North Carolina adopted federal adjusted gross income as the starting point in determining North Carolina taxable income. Since the elements involved in computing the NOL are included in the calculation of federal adjusted gross income, this change did not have any effect on the treatment of the NOL when determining North Carolina taxable income. The law does not require or permit a separate calculation of an NOL for State purposes. The amount of NOL remains the same for State and federal purposes. An NOL must be carried to the same tax year(s) for federal and State individual income tax purposes.

2. Determining Net Operating Losses

Because federal adjusted gross income is the starting point for determining North Carolina taxable income, the amount of NOL determined for federal income tax purposes is also the NOL for State income tax purposes. Although adjustments to federal adjusted gross income may be required which cause North Carolina taxable income to be different than federal adjusted gross income in the year the loss is incurred, the law does not require or permit a separate calculation of an NOL for State purposes. The amount of NOL is the same for State and federal purposes. However, a nonresident or part-year resident must make an additional calculation to determine the portion of the total NOL that is from North Carolina sources.

3. Net Operating Loss Carryovers

Because federal adjusted gross income is the starting point for determining North Carolina taxable income, generally the amount of NOL carried over and absorbed for federal purposes is the same amount carried over and deducted for State purposes. "Absorbed" means the amount of NOL carried to a year less the amount of NOL carried forward from that year. If, in the year to which the loss is carried, adjustments are required to the State return which result in the taxpayer not receiving full benefit of the carryover, no additional carryover of the portion of the loss not resulting in a benefit is permitted.

For an NOL carried over to taxable years beginning prior to January 1, 2014, or to taxable years beginning on or after January 1, 2016, and not completely absorbed for federal purposes, an addition to federal taxable or federal adjusted gross income is required on the State return for the amount of NOL carried forward from that year.

Example. A taxpayer incurs an NOL of $75,000 in 2015. The taxpayer amends his 2013 federal return to carry back the NOL and deducts the entire loss in arriving at federal adjusted gross income. Only $50,000 of the loss is absorbed and $25,000 is carried forward to the 2014 federal return. To determine North Carolina taxable income, the taxpayer must make an addition to federal adjusted gross income, as amended, of $25,000 on his amended 2013 State return.

For an NOL carried over to tax year 2014 or 2015, an addition is not required even if the NOL is not absorbed for federal purposes.

4. Effect of Residency Status on Net Operating Losses

As stated earlier, the amount of NOL carried over and absorbed for federal tax purposes is also the amount carried over and deducted for State tax purposes.

If the taxpayer is a nonresident or a part-year resident in the year the NOL is incurred and a resident in the year to which the loss is carried, the taxpayer receives the full benefit of the deduction, regardless of whether the NOL resulted from North Carolina source activities.

If the taxpayer is a resident in the year the NOL is incurred and a nonresident or part-year resident in the year to which the loss is carried, the taxpayer may subtract the entire portion of the NOL carried over and absorbed for federal purposes that year from both the numerator and denominator of the fraction used to calculate North Carolina taxable income for nonresidents and part-year residents.

If the taxpayer is a nonresident or a part-year resident in the year the NOL is incurred and a nonresident in the year to which the loss is carried, the taxpayer must determine the percentage of the NOL that was from North Carolina sources. The percentage is then multiplied by the amount of NOL absorbed for the year to which the loss is carried. The numerator of the fraction used to calculate North Carolina taxable income is reduced by the result while the denominator is reduced by the portion of the total NOL carried over and absorbed in that year for federal purposes.

Example 1. A nonresident taxpayer incurs an NOL of $100,000 in 2015, $70,000 of which is from North Carolina sources. The portion of the NOL that is from North Carolina sources is .70 ($70,000 divided by $100,000). If the taxpayer carries the loss back to 2013 when the taxpayer was a nonresident and absorbs $40,000 in that year, the portion of that loss deemed to be from North Carolina sources and subtracted in determining the numerator of the fraction is $28,000 ($40,000 x .70). The denominator is reduced by the entire $40,000.

If the taxpayer is a nonresident or a part-year resident in the year the NOL is incurred and a part-year resident in the year to which the loss is carried, the taxpayer must first compare the amount of income taxable to North Carolina while a resident to the amount of NOL absorbed for federal purposes in the year to which the loss is carried. If the amount of NOL absorbed in the year is less than the amount of income taxable to North Carolina while a resident, the entire portion of the NOL carried over and absorbed for federal purposes is used to reduce the numerator of the fraction used to calculate North Carolina taxable income. If the amount absorbed in the year is greater than the amount of income taxable while a resident, the amount of absorbed NOL remaining after subtracting the income taxable while a resident is multiplied by the percentage of the NOL that is from North Carolina sources to determine any additional NOL that may be used to reduce the numerator. The denominator is reduced by the portion of the total NOL carried over and absorbed in that year for federal purposes.

Example 2. A nonresident taxpayer incurs an NOL of $100,000 in 2015. No portion of the NOL is from North Carolina sources. The taxpayer carries the loss back to 2013 when he was a part-year resident and $50,000 of his total income was taxable to North Carolina. $40,000 of the NOL is absorbed in 2013. The numerator and denominator are reduced by the entire $40,000.

Example 3. A nonresident taxpayer incurs an NOL of $100,000 in 2015. No portion of the NOL is from North Carolina sources. The taxpayer carries the loss back to 2013 when he was a part-year resident and $50,000 of his total income was taxable to North Carolina while a resident. $80,000 of the NOL is absorbed in 2013. The numerator is reduced by $50,000 and the denominator is reduced by the entire $80,000.

Example 4. A nonresident taxpayer incurs an NOL of $100,000 in 2015, $70,000 of which is from North Carolina sources. The portion of the NOL that is from North Carolina sources is .70 ($70,000 divided by $100,000). The taxpayer carries the loss back to 2013 when he was a part-year resident and $25,000 of his total income was taxable to North Carolina while a resident. $40,000 of the NOL is absorbed in 2013. The numerator is reduced by $35,500, calculated as follows: $25,000 + ($40,000-$25,000) x .70. The denominator is reduced by the entire $40,000.

5. Claiming a Net Operating Loss

a. **Carrying back an NOL.** For federal tax purposes, a taxpayer carrying back an NOL may use federal Form 1040X or, if a refund is due, federal Form 1045. North Carolina does not have a form similar to federal Form 1045; therefore, the taxpayer must file an amended North Carolina income tax return to carry back an NOL. For more information, see

"Amended Returns." A copy of federal Form 1045, including Schedule A, must be provided with the amended North Carolina return for each year to which the loss is carried back. For any year in which the loss is carried back but not completely absorbed, a copy of Schedule B of federal Form 1045 must also be provided. In lieu of federal Form 1045, a worksheet containing the same information as federal Form 1045 is acceptable.

b. **Carrying an NOL forward.** For federal tax purposes, a taxpayer carrying an NOL forward reports the loss as "Other Income" on the federal return. A copy of federal Form 1045, Schedule A, or similar worksheet identifying the year in which the NOL was incurred and showing how the NOL was calculated must be attached to each State return to which the loss is carried over. For any year in which the loss is carried over but not completely absorbed, a copy of the Worksheet for NOL Carryover included in federal Publication 536 or a similar worksheet must also be provided.

c. **Nonresidents and part-year residents**. A taxpayer who is a nonresident or part-year resident in the year to which an NOL is carried over must include a schedule showing the calculation of the amount subtracted in arriving at the numerator of the fraction used to determine North Carolina taxable income.

6. Statute of Limitations

For both State and federal tax purposes, the period of time in which a taxpayer may claim a refund resulting from the carryback of an NOL is extended beyond the general period of limitations for claiming a refund. The period of time for claiming a refund from the carryback of an NOL expires three years after the date the return is due, including extensions, for the year in which the loss is incurred, not the year to which the loss is carried. For example, a calendar year taxpayer who incurs an NOL in tax year 2016 and files the 2016 return by April 15, 2017, has until April 15, 2020 to file a claim for refund for tax year 2014 because of the carryback of the NOL.

7. Calculation of Interest on Overpayments

Interest accrues on an overpayment of individual income tax from a date 45 days after the latest of the following dates: (1) the date the final return is filed; (2) the date the final return was due to be filed; (3) the date of the overpayment, until the refund is paid. An overpayment resulting from the carryback of an NOL is considered to have occurred on the date the income tax return for the year in which the loss was incurred is filed or due to be filed, whichever is the later. Therefore, no interest accrues on the overpayment if refunded within 45 days of the date the tax return for the loss year is filed.

For more information, see "Interest Rate."

VII. Subject: Nonresident and Part-Year Resident (G.S. § 105-153.4(b)) (G.S. § 105-153.4(c)) (G.S. 105-153.4(d))

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 of a tax 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 removes 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 or five years.

1. Place of birth of the taxpayer, the taxpayer's spouse, and the taxpayer's children.
2. Permanent residence of the taxpayer's parents.
3. Family connections and close friends.
4. 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.
5. Civic ties, such as church membership, club membership, or lodge membership.
6. Professional ties, such as licensure by a licensing agency or membership in a business association.
7. Payment of state income taxes.
8. Place of employment or, if self-employed, place where business is conducted.

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

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

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

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

13. Location of pets.

14. 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.

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

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

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

1. Selling a house and buying a new one.

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

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

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

5. Registering a vehicle in a new jurisdiction.

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

7. 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 his military pay whether he 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 serviceman must not only be present in the new location with the intention of making it his domicile, but must also factually establish that he has done so.

2. Nonresident (17 NCAC 06B .3902)

"G.S. § 105-153.3(11)" defines a "nonresident" 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.

Under the Servicemember's Civil Relief Act, a member of the Armed Services who is a legal resident of another state stationed in North Carolina by virtue of military orders is not subject to North Carolina income tax on service pay but other income from employment, a business, or tangible property in North Carolina is subject to North Carolina income tax.

Military Spouses. The Military Spouses Residency Relief Act of 2009 amended the Servicemember's Civil Relief Act to provide 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 if the residence or domicile is the same for both the servicemember and the spouse.

Therefore, effective for tax years beginning on or after January 1, 2009, 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 (1) the servicemember is present in North Carolina solely in compliance with military orders; (2) the spouse is in North Carolina solely to be with the servicemember; and (3) the spouse is domiciled in the same state as the servicemember. All three of the conditions must be met to qualify for the exemption.

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

For more information, see "Active Military" and "Frequently Asked Questions about the Military Spouses Residency Relief Act of 2009."

3. Part-Year Resident (17 NCAC 06B .3903)

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

4. Taxable Income of Nonresidents and Part-Year Residents (G.S. § 105-153.4) (17 NCAC 06B .3904)

Nonresidents and part-year residents are required to prorate their federal adjusted gross income to determine the portion that is subject to North Carolina tax.

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 Internal Revenue 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.

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 Internal Revenue 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.

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 on the North Carolina income tax return. A nonresident is not entitled to the tax credit for tax paid to another state or country.

For more information, see "Nonresidents and Part-Year Residents".

5. Nonresident Members of Professional Athletic Teams (17 NCAC 06B .3905)

To determine the portion of his or her total 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 his or her total compensation for services rendered as a member of a professional athletic team during the taxable year by a fraction, the numerator of which 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 Internal Revenue 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 as a result 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 of 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; and

      c. the signing bonus in nonrefundable.

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

VIII. Subject: S Corporations (G.S. § 105-131)

1. General (G.S. § 105-131.1)

An individual shareholder of an S corporation is required to take into account his or her pro rata share of an S corporation's net income in the manner provided under Section 1366 of the Internal Revenue Code subject to certain adjustments.

2. Resident Shareholder

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

3. Nonresident Shareholders (G.S. §105-131.5) (G.S. § 105-131.7) (G.S. § 105-153.4) (17 NCAC 06B .4003)

A nonresident shareholder of an S corporation takes into account only his or her 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 his or her behalf by the S corporation to North Carolina on his or her share of the S corporation income.

4. Tax Credits (G.S. § 105-131.8) (17 NCAC 06B .4004)

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 his or her individual income tax return for his or her share of the tax paid to the other state or country. A shareholder claiming the tax credit must attach a schedule to his or her income tax return reflecting the total amount of tax paid to the other state or country by the S corporation, and explaining how his or her pro rata share of the 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.

5. Basis in Stock (G.S. § 105-131.3) (17 NCAC 06B .4005)

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 his or her 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 his or her 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).

6. Distributions (G.S. § 105-131.6) (17 NCAC 06B .4006)

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 Internal Revenue 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 his stock. If the distribution exceeds his 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 basically 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 his 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.

The following examples illustrate adjustments required in determining North Carolina taxable income of a shareholder from distributions of S corporations:

Note. The examples may refer to adjustments to federal taxable income or adjustments to federal adjusted gross income. Federal taxable income was the starting point for determining

North Carolina income for tax years 1989 through 2011. For tax years 2012 forward, federal adjusted gross income is the starting point for determining North Carolina taxable income.

(1) A North Carolina corporation chartered on January 1, 1986, elected to be taxed as an S corporation for federal income tax purposes. Taxpayer A invested $100,000 in the corporation; and at the end of the tax year 1988, A's pro rata share of the S corporation's accumulated adjustments account for federal income tax purposes was $50,000. A's pro rata share of the S corporation's net income for the tax year 1989 was $20,000. The S corporation distributed $100,000 to A during the tax year 1989. In this case, A would include his $20,000 share of the S corporation's net income in his federal taxable income. For federal income tax purposes, A would not be taxed on any part of the $100,000 distribution since it is considered to have been paid from his accumulated adjustments account and reduces the basis of his stock.

Original investment	$ 100,000
Accumulated adjustments account at the end of 1989 ($50,000 plus $20,000)	70,000
Adjusted basis of stock at end of year	$ 170,000
Less: Distribution	(100,000)
Adjusted basis of stock as of January 1, 1990	$ 70,000

For State income tax purposes, the $50,000 accumulated adjustments account balance on December 31, 1988, is treated as additional earnings and profits and A's federal taxable income must be increased for any part of the distribution attributable to earnings and profits in determining North Carolina taxable income. The amount is determined as follows:

Investment in the corporation		$ 100,000
Pro rata share of 1989 earnings — accumulated adjustments account		20,000
Adjusted basis in stock at end of tax year		$ 120,000
Distributions	$.100,000	
Applied to accumulated adjustments account	(20,000)	(20,000)
Balance of distribution	$ 80,000	
Earnings and profits	(50,000)	
Balance of distribution	$ 30,000	(30,000)
Basis in stock as of January 1, 1990		$ 70,000

The $50,000 from earnings and profits is a transitional adjustment and represents a dividend to the shareholder.

(2) Shareholders of a North Carolina C corporation elect to be taxed as an S corporation effective for the tax year beginning January 1, 1989. Taxpayer B, a resident of North Carolina, owned 4,000 shares of the corporate stock with a basis of $500,000 at the time of the election. At that time, B's pro rata share of the C corporation's undistributed

earnings and profits was $800,000. During the tax year 1989, his pro rata share of the S corporation's earnings was $50,000 and the corporation distributed $1,000,000 to B in 1989. In this case, B would include in federal taxable income his $50,000 pro rata share of the S corporation's net income and dividends of $800,000 representing his share of the undistributed earnings and profits accumulated during the period the corporation operated as a C corporation. His basis in the corporate stock for federal tax purposes would be reduced to $350,000 determined as follows:

Cost of stock		$500,000
1989 earnings — added to accumulated adjustments account		50,000
Basis before deductions		$ 550,000
Distributions	$ 1,000,000	
Applied to accumulated adjustments account	(50,000)	(50,000)
Balance	$950,000	
Applied to earnings and profits	(800,000)	
Balance of distribution	$ 150,000	(150,000)
Basis in stock as adjusted as of January 1, 1990		$350,000

No adjustment would be necessary in determining North Carolina taxable income since the State and federal accumulated adjustments account and the accumulated earnings and profit account are the same.

(3) Shareholders of a North Carolina C corporation elected to be taxed as an S corporation for federal income tax purposes effective January 1, 1986. At that time, taxpayer X owned 200 shares of the stock with a cost basis of $50,000. X's pro rata share of the C corporation's undistributed earnings and profits on January 1, 1986, was $20,000. His pro rata share of the earnings of the S corporation was $10,000; $5,000; ($10,000); and $15,000, respectively, for the tax years 1986, 1987, 1988 and 1989. No distributions were made to X in the tax years 1986 and 1988. Distributions were made to X of $10,000 in 1987 and $35,000 in 1989. In this case, X must include his pro rata share of the 1989 earnings of $15,000 in his 1989 federal taxable income. The part of the $35,000 distribution that is included in federal taxable income as a dividend is determined as follows:

Distributions in 1989		$ 35,000
Accumulated adjustments account -		
1986 share of income	$ 10,000	
1987 share of income	5,000	
1987 distribution	(10,000)	
1988 share of income (loss)	(10,000)	
Balance as of 12/31/88	(5,000)	
1989 share of income	15,000	
Total.		10,000

Balance of distribution		$ 25,000
Applied to undistributed earnings while a C corporation (dividend)		20,000
Excess distribution applied to reduce basis		$ 5,000

For federal tax purposes, X must include the $20,000 distribution of earnings and profits in his federal taxable income as dividends. The adjustment required in computing his North Carolina taxable income is determined as follows:

Distributions in 1989		$ 35,000
Applied to accumulated adjustments account - (1989 share of income)		15,000
Balance of distribution		$ 20,000
Undistributed earnings and profits:		
Balance January 1, 1986	$ 20,000	
Federal accumulated adjustments account as of December 31, 1988	(5,000)	
Earnings and profits as adjusted for State tax purposes (treated as dividend)	15,000	(15,000)
Excess distribution applied to reduce basis	$ 5,000	

X would be entitled to deduct $5,000 ($20,000 less $15,000) from his federal taxable income as an adjustment in computing his North Carolina taxable income.

7. Losses (G.S. § 105-131.4)

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.

8. Foreign S Corporations

North Carolina income tax is required to be withheld from compensation paid to foreign S corporations for certain personal services performed in North Carolina. For more information, see "Withholding from Nonresidents for Certain Personal Services and Withholding on Contractors Identified by an Individual Taxpayer Identification Number (ITIN)". If the S corporation has obtained a certificate of authority from the Secretary of State, no tax is required to be withheld if the S corporation provides to the payer the S corporation's corporate identification number issued by the Secretary of State.

S Corporations may claim credit on the S corporation franchise and income tax return, "Form CD-401S," for the portion of the tax withheld attributable to shareholders on whose behalf the corporation files a composite return. The portion of the tax withheld attributable to shareholders who are not part of a composite return must be allocated to those shareholders on Schedule K of the S corporation return.

9. Time and Place for Filing Returns (G.S 105 § 105-131.7)

"Form CD-401S" is required to be filed 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 S corporation may apply for an automatic six month extension of time to file the return. To receive the extension, the S corporation must file "Form CD-419," Application for Extension for Filing Corporate Income and Franchise Tax Return, by the original due date of the return. For information on when a document is considered timely filed, see "Departmental Directive TA-16-1".

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" ("Form D-400"), click "here."

IX. Subject: Estates and Trusts (G.S. § 105-160)

1. 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.

2. Income Tax Return for Estates and Trusts (G.S. § 105-160.2) (17 NCAC 06B .3716)

The federal taxable income of the fiduciary 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. In addition, an estate and trust must add to federal taxable income any state, local, or foreign income tax deducted on the federal estates and trusts return.

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. **Exception:** With respect to grantor trust returns, North Carolina has access to the federal information contained in the federal grantor trust returns. Therefore, a State grantor trust return is not required to be filed when the entire trust is treated as a grantor trust for federal tax purposes.

3. Time and Place for Filing an Estates and Trust Tax Return (G.S. § 105-160.6)

"Form D-407" is required to be filed 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. To receive the extension, the fiduciary must file "Form D-410P," Application for Extension for Filing Partnership, Estate, or Trust Return, by the original due date of the return. For information on when a document is considered timely filed, see "Departmental Directive TA-16-1."

4. Payment of Tax (G.S. § 105-160.2)

The tax rate for estates and trusts is the same as the tax rate for individuals. The tax due on the estates and trusts return is payable in full by the due date of the return. For more information, see "Tax Rate Schedules."

5. Penalties (17 NCAC 06B .3203)

The penalty for failure to file an estate or trust return by the due date is 5% of the tax per month with a maximum of 25% of the net tax due. 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. The penalty for failure to pay the tax by the due date is 10% of the total amount of tax due.

Other penalties for fraud, negligence, and criminal penalties for willful failure to comply with the income tax laws are similar to those applicable to individuals. For more information, see "Penalties and Interest."

6. Allocation of Adjustments (17 NCAC 06B .3723)

The additions and deductions to 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 provide 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 State 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 State 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.

7. Allocation of Income Attributable to Nonresidents (17 NCAC 06B .3724)

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.

8. Tax Credits (G.S. § 105-160.3) (17 NCAC 06B .3714)

Estates and trusts are allowed all tax credits allowed to individuals except:

a. Tax credit for income taxes paid by individuals to other states or countries, and
b. Tax credit for children

"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 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)."

A resident beneficiary of an estate or trust, the fiduciary of which pays an income tax to another state or country on distributable income reportable to North Carolina which is derived from sources in the other state or country may claim a credit against his North Carolina income tax for his share of tax paid to the other state or country under the provisions of "G.S. § 105-160.4(e)."

"Part 5 of Form D-407TC" is to be 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.

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 total gross income to be used in the tax credit computation schedule is the total gross income from federal Form 1041.

X. Subject: Partnerships (G.S. § 105-154)

1. General (17 NCAC 06B .3501)

The starting point for preparing the North Carolina partnership income tax return is total income or loss from lines 1 through 11 of Schedule K, Federal Form 1065. The additions and deductions required for individuals under "G. S. § 105-153.5" and "G.S. § 105-153.6" also apply to partnerships. In addition, a partnership must add to income any state, local, or foreign income tax deducted on the federal partnership return.

2. Time and Place for a Partnership Return (G.S. § 105-155) (17 NCAC 06B .3503)

A North Carolina partnership 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 when a document is considered timely filed, see "Departmental Directive TA-16-1

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. To receive the 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.

The 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 this 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.

3. Schedule NC K-1 (G.S. § 105-154) (17 NCAC 06B .3503)

"Schedule NC K-1" is used by the partnership to report each partner's share of the partnership's income, adjustments, tax credits, tax paid, etc. The NC K-1 must reflect the net tax paid by the partnership. The partnership must provide a completed Schedule NC K-1, or other documents containing all of the information that would be reported on Schedule NC K-1, to each person who was a partner in the partnership at any time during the year. This schedule 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.

4. Penalties (17 NCAC 06B .3203)

The penalty for failure to file a partnership return on which tax is due by the due date is 5% of the net tax due for each month, or part of a month, the return is late. The maximum penalty is 25% of the unpaid tax. 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.

If a partnership does not pay the total amount of tax due on or before the original due date of the return, a late payment penalty of 10% of the unpaid tax is due. If the partnership has a valid extension of time for filing the return, a 10% late payment penalty will apply on the remaining balance due if the tax paid by the original due date is less than 90% of the total amount of tax due. In addition, penalties are provided by law for willful failure to file a return on time and for willful attempt to evade or defeat the tax.

For more information, see "Penalties and Interest."

5. Nonresident Partners (G.S. § 105-154) (17 NCAC 06B .3513)

When an established business in North Carolina is owned by a partnership having one or more nonresident members, the managing partner 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. If the nonresident partner is a corporation, partnership, trust or estate, the managing partner is not required to pay the tax on that partner's share of the partnership income if the partner provides "Form NC-NPA," Nonresident Partner Affirmation. Form NC-NPA affirms that the partner will pay the tax with its corporation, partnership, trust. or estate income tax return. In such cases, a copy of Form NC-NPA must be attached to the partnership return when it is originally filed. The Form NC-NPA must be signed by the partner. An unsigned form is not considered valid. A new Form NC-NPA must be provided by the nonresident partner and submitted by the managing partner each year. The signed Form NC-NPA applies to the original return, any amended returns for that year, and any proposed assessments of additional tax for that year. (**Note:** This provision does not extend to grantor trusts because no tax is paid on grantor trust returns.)

The tax rate is the same as the tax rate for individuals. See "Tax Rate Schedules."

Payment of the tax due by the managing partner 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 managing partner may be claimed on the income tax return. 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.

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 paid the tax due for the nonresident individual partner. 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 Schedule NC K-1 or other document from the partnership verifying that the partnership paid tax on behalf of the partner.

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

Publicly Traded Partnerships. Effective for tax years beginning on or after January 1, 2008, a publicly traded partnership as described in Section 7704 of the Internal Revenue Code is required to file an information return only for those 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.

6. Disposition of Partner's Interest (17 NCAC 06B .3527)

An interest in a partnership is intangible personal property. Nonresident partners do not include the gain from the sale of their interest in a partnership in the numerator of the fraction 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 partners do 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.

Nonresident partners 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 partnership interests conveys title to specific partnership property instead of to limited interests in the partnership, the transaction will be considered as a sale of partnership assets for purposes of determining North Carolina taxable income.

7. Part-Year Residents (G.S. § 105-153.4) (17 NCAC 06B .3528)

Part-year residents 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 their 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.

8. Estimated Income Tax (17 NCAC 06B .3521)

No estimated income tax is required of a partnership. Resident individual partners who meet statutory requirements must pay 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.

9. Interest Income Passed Through to Partners (17 NCAC 06B .3529)

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 his 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.

10. Income Tax Credits of Partnerships (G.S. § 105-269.15)

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.

11. Limited Liability Companies

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 is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership. Limited liability companies are subject to State taxation according to their classification for federal income tax purposes; therefore, if a limited liability company is classified as a partnership for federal income tax purposes, the company and its members are subject to tax to the same extent as a partnership and its partners and is required to file a North Carolina partnership return.

A limited liability company may be organized by a single member by delivering executed articles of organization to the Secretary of State.

12. Foreign Partnerships

North Carolina income tax is required to be withheld from compensation paid to foreign partnerships for certain personal services performed in North Carolina. For more information, see "Withholding from Nonresidents for Certain Personal Services and Withholding on Contractors Identified by an Individual Taxpayer Identification Number (ITIN)." 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.

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

13. Investment Partnerships (17 NCAC 06B .3503)

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 Internal Revenue 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.

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.

XI. Subject: Taxable Status of Distributions from Regulated Investment Companies

1. General (17 NCAC 06B .4101)

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.

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 (17 NCAC 06B .4103)

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.

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.

XII. Subject: Tax Credits (Article 3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H, 3J, 3K, 3L and 4)

1. Overview

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

a. Effect on Installments and Carryforwards

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

b. Forms

"Form D-400TC" is used to report credits that are not limited to fifty percent (50%) of the tax. The Form NC-478 series is used to calculate and report tax credits that are limited to fifty percent (50%) of the tax, less the sum of all other credits that the taxpayer claims. Forms NC-478A through NC-478L are used to calculate the specific credits without regard to the fifty percent (50%) limitation. "Form NC-478" is used to total the specific credits, to determine if the fifty percent (50%) limitation applies, and allocate the limited total credit among the specific credits.

"Form D-400TC" and, if applicable, "Form NC-478" and the corresponding Form NC-478 series form must be filed for any taxable year in which the taxpayer is eligible to claim acredit, take a credit, or take an installment of a credit against the taxpayer's tax liability for that year. This requirement applies even if the taxpayer's tax liability for that year is not large enough for the taxpayer to benefit from the credit.

2. Article 4 Tax Credits

1. Overview

The following tax credits were **repealed** effective for taxable years beginning on or after January 1, 2014:

- Credit for Construction of Dwelling Units for Handicapped Persons (G.S. § 105-151.1)
- Credit for Child Care and Certain Employment-Related Expenses (G.S. § 105-151.11)
- Credit for Certain Real Property Donations (G.S. § 105-151.12)
- Credit for Conservation Tillage Equipment (G.S. § 105-151.13)
- Credit for Gleaned Crop (G.S. § 105-151.14)
- Credit for Disabled Taxpayer, Dependent, or Spouse (G.S. § 105-151.18)
- Credit or Partial Refund for Tax Paid on Certain Federal Retirement Benefits
- (G.S. § 105-151.20)
- Credit for Property Taxes Paid on Farm Machinery (G.S. § 105-151.21)
- Credit for Construction of a Poultry Composting Facility (G.S.§ 105-151.25)
- Credit for Charitable Contributions by Nonitemizers (G.S. § 105-151.26)
- Education Expenses Credit (G.S. § 105-151.33)

The following tax credits were **repealed** as of January 1, 2014:

- Credit for North Carolina State Ports Authority Wharfage, Handling, and Throughput Charges (G.S. § 105-151.22)
- Credit for Premiums Paid on Long-term Care Insurance (G.S. § 105-151.28)
- Credit for Recycling Oyster Shells (G.S. § 105-151.30)
- Earned Income Tax Credit (G.S. § 105-151.31)
- Credit for Adoption Expenses (G.S. § 105-151.32)
- Tax Credits for Qualified Business Investments (for investments made on or after January 1, 2014) (Article 4, Part 5)

The following tax credit was **repealed** for qualifying expenses occurring on or after January 1, 2015:

- Credit for Qualifying Expenses of a Production Company (G.S. § 105-151.29)

2. Credit for Corporate Tax Paid by S Corporation to another State or Country (G.S. § 105-131.8)

Credit is allowed to a resident shareholder for his share of the corporate tax paid by an S corporation to another state or country that taxes the corporation rather than the shareholder on the S corporation's income, or the computed credit, whichever is less. If credit is claimed for the shareholder's part of the corporate tax paid, a schedule must be attached to the North

Carolina return showing the total tax paid by the S corporation and how the pro rata share of the tax was determined. A separate tax credit must be calculated for each state or country to which the S corporation paid tax.

3. Credit for Income Tax Paid to another State or Country (G.S. § 105-153.9) (17 NCAC 06B .0607)

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 must be paid to North Carolina within thirty days of the date of receipt of this refund or notice of the credit.

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 the smaller.

Example 1. A full-year resident of North Carolina files a 2016 North Carolina return as a single individual. His total federal gross income is $37,750. He worked temporarily in South Carolina, earning $5,000 on which he paid tax of $131 to South Carolina. Taxpayer claimed the N.C. standard deduction of $8,250. The credit against his North Carolina income tax is determined as follows:

Federal adjusted gross income .... $ 37,750
Less: N.C. standard deduction .... (8,250)
North Carolina taxable income .... $ 29,500

North Carolina tax.. $ 1,696

Less tax credit:
Portion of total federal gross income, while a resident of N.C.,
as adjusted, taxed by South Carolina $ 5000 x $ 1,696 = $225
Total federal gross income $37,750
as adjusted, while a resident of N.C.

Since the $131 tax paid to South Carolina is less than the computed tax credit of $225, the allowable tax credit is the actual tax paid to South Carolina .... $ (131)

North Carolina tax due... $ 1,565

Example 2. A husband and wife are both residents of North Carolina and file a joint 2016 North Carolina income tax return. Their total federal gross income is $40,000, $5,500 of which was received from rental property, owned jointly, in Virginia. A total of $2,000 was received by the husband for temporary employment in South Carolina. The taxpayers claimed the N.C. standard deduction of $16,500. They paid tax of $290 on the income earned in Virginia and the husband paid tax of $102 on the income reported to South Carolina. The credit against their North Carolina income tax is determined as follows:

Federal adjusted gross income .... $ 40,000
Less: N.C. standard deduction .... (16,500)
North Carolina taxable income .... $ 23,500

North Carolina tax.. $ 1,351

Less tax credit:
Portion of total
federal gross income while a resident of N.C.,
as adjusted, taxed by Virginia $5,500 x $ 1,351 = $186
Total federal gross income, $40,000
as adjusted, while a resident of N.C.

Portion of total
federal gross income while a resident of N.C.,
as adjusted, taxed by South Carolina $2,000 x $ 1,351 = $ 68
Total federal gross income, $40,000
as adjusted, while a resident of N.C.

Total credit ....$ (254)
North Carolina tax due ....$ 1,097

The computed credits are allowed since each is less than the amount paid to the other state.

Example 3. Taxpayer, a single man, became a North Carolina resident on June 1, 2016. Prior to moving to North Carolina, he earned $4,000 in South Carolina. From June 1 through December 31, 2016, he earned $6,000 in South Carolina and $10,000 in North Carolina. He paid income tax to South Carolina of $300 on the $10,000 of South Carolina income. The taxpayer claimed the N.C. standard deduction of $8,250. His tax credit is determined as follows:

Federal adjusted income ....$ 20,000
Less: N.C. standard deduction ....(8,250)
North Carolina taxable income before part-year resident adjustment ....$ 11,750

Total federal gross income, as adjusted, while a N.C. resident plus total income from N.C. sources while a nonresident as adjusted	$16,000	x	$11,750 =	$9,400
Total federal gross income from all sources as adjusted	$20,000			N.C. taxable income

North Carolina taxable income ....$ 9,400
North Carolina tax on $9,400 taxable
Income...$ 541

Less tax credit:

Portion of total federal gross income, while a N.C. resident, as adjusted, taxed by S.C.	$ 6,000	x	$541 =	$203*
Total federal gross income while a N.C. resident, as adjusted	$16,000			N.C. tax

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

S.C. income taxed by N.C.	$ 6,000	x	$300 =	$180**
Total S.C. income	$10,000			S.C. tax

Since the $180 tax paid to South Carolina on income also taxed by
North Carolina is less than the $203 computed credit, the allowable credit = ($180)

North Carolina tax due ....$ 361

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

4. Credit for Children (G.S. § 105-153.10)

An individual may claim a child tax credit for each dependent child for whom a federal child tax credit was allowed under section 24 of the Code. The amount of credit allowed for the taxable year is equal to the amount listed in the table below based on the individual's adjusted gross income, as calculated under the Code ("Form D-400, Line 6").

<table>
<tr><th>Filing Status</th><th>Federal Adjusted Gross Income</th><th>Credit Amount per Qualifying Child</th></tr>
<tr><td rowspan="3">Married Filing Jointly/ Qualifying Widow(er) with dependent child (Surviving Spouse)</td><td>Up to $40,000</td><td>$125</td></tr>
<tr><td>Over $40,000 and up to $100,000</td><td>$100</td></tr>
<tr><td>Over $100,000</td><td>$0</td></tr>
<tr><td rowspan="3">Head of Household</td><td>Up to $32,000</td><td>$125</td></tr>
<tr><td>Over $32,000 and up to $80,000</td><td>$100</td></tr>
<tr><td>Over $80,000</td><td>$0</td></tr>
<tr><td rowspan="2">Married Filing Separately</td><td>Over $20,000 and up to $50,000</td><td>$100</td></tr>
<tr><td>Over $50,000</td><td>$0</td></tr>
</table>

The credit for children can be claimed only for a child who was under 17 years of age on the last day of the year. A part-year resident or nonresident may claim a prorated credit based on the percentage of income that is subject to North Carolina tax.

The instructions for the "Credit for Children" and the "Credit for Children Worksheet" are located in the North Carolina Individual Income Tax Instructions ("Form D-401"). On "Form D-400TC," enter the number of dependent children for whom you were allowed a federal tax credit on and the amount of the credit.

3. Tax Incentives for New and Expanding Businesses (Article 3A)

For most taxpayers, Article 3A credits expired for activities incurred prior to January 1, 2007. Eligible taxpayers may continue to take remaining installments and carryforwards of prior year credits by completing the applicable Form NC-478 series form. To obtain a Form NC-478 or the applicable NC-478 series form, click "here."

4. Business & Energy Tax Credits (Article 3B)

1. General Information (*Applies to all credits under this Article unless otherwise noted.)*

a. Franchise, Income, or Gross Premium Tax Election (G.S. § 105-129.17(a))

The credits allowed under Article 3B can be taken against franchise or income tax, but not against insurance gross premium tax unless otherwise noted. The taxpayer must elect the tax against which a credit will be claimed when filing the return on which the first installment of the credit is claimed. This election is binding. All future installments and carryforwards of a credit must be claimed against the same tax.

b. Cap on Credit (G.S. § 105-129.17(b))

Total credits, including carryforwards, claimed under Article 3B may not exceed fifty percent (50%) of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits, including carryforwards, against that tax, except tax payments made by or on behalf of the taxpayer.

c. Credit Carryforward (G.S. § 105-129.17(b))

Unused portions of the credits may be carried forward for the succeeding five (5) years unless otherwise noted, but must be taken against the same tax as on the return on which the credit was first taken.

d. Substantiation (G.S. § 105-125.18)

The burden of proving eligibility for any credit under this article rests upon the taxpayer. Every taxpayer claiming a credit under this article must maintain and make available for inspection by the Secretary of Revenue any records the Secretary considers necessary to determine and verify the amount of the credit to which the taxpayer is entitled. No credit may be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

2. Credit for Investing in Renewable Energy Property (G.S. § 105-129.16A)

a. Credit *(Repealed effective for renewable energy property placed into service on or after January 1, 2016)*

A taxpayer that has constructed, purchased, or leased renewable energy property is allowed a credit equal to thirty-five (35%) of the cost of the property if the property is placed into service during the taxable year. No credit is allowed to the extent the cost of the renewable energy property was provided by public funds.

If the taxpayer owns the property, the cost is determined in accordance with section 1012 of the Code and is subject to the limitation on cost provided in section 179 of the

Code. If the property is leased, the cost is eight (8) times the net annual rental rate. The net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The sub-rentals are not deducted if they are business income for the taxpayer.

If the property serves a single-family dwelling, the credit is taken for the taxable year in which the property is placed in service. For all other property, the credit is taken in five (5) equal installments beginning with the year the property is placed in service.

This credit can be taken against franchise tax, income tax, or against insurance gross premium tax. For more information on this credit, refer to the "2014 Guidelines for Determining the Tax Credit for Investing in Renewable Energy Property."

b. Cap on Credit (G.S. § 105-129.16A(c))

The maximum credit allowed for business property is two million five hundred thousand dollars ($2,500,000) per installation. The credit ceilings for nonbusiness property are:

- One thousand four hundred dollars ($1,400) per dwelling unit for solar energy equipment for domestic water heating, including a system that heats a pool.
- Three thousand five hundred dollars ($3,500) per dwelling for solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating.
- Eight thousand four hundred dollars ($8,400) for each installation of geothermal equipment.
- Ten thousand five hundred dollars ($10,500) per installation for any other renewable energy property for residential purposes.

c. Eligible Renewal Energy Property (G.S. § 105-129.15)

Any of the following machinery and equipment or real property is considered to be eligible renewable energy property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; commercial thermal or electrical generation. Effective for taxable years beginning on or after January 1, 2006 electrical generation is no longer restricted to using renewable energy crops or wood waste material. Biomass equipment includes any equipment used for converting, conditioning and storing the liquid fuels, gas and electricity produced with biomass equipment.

- Combined heat and power systems property. Defined in section 48 of the Code.

- Geothermal equipment that meets either of the following descriptions: (1) It is a heat pump that uses the ground or groundwater as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure, or (2) It uses the internal heat of the earth as a substitute for traditional energy for water heating or active space heating or cooling.

- Hydroelectric generators located at existing dams or waterways and related devices for water supply and control and converting, conditioning, and storing the electricity generated.

- Solar energy equipment that uses solar radiation as a substitute for traditional energy for water heating, active space heating and cooling, passive heating, daylighting, generating electricity, distillation, desalination, detoxification, or the production of industrial or commercial process heat. Solar energy equipment includes any equipment used for collecting, storing, exchanging, conditioning, or converting solar energy to other useful forms of energy.

- Wind equipment required to capture and convert wind energy into electricity or mechanical power and related devices.

d. Expiration of Credit (G.S. § 105-129.16A(b))

If the property is disposed of, taken out of service, or moved out of North Carolina during the five year installment period, the credit expires and a taxpayer may not take any remaining installment of the credit except for the portion of an installment that accrued in a previous year and has been carried forward. No credit is allowed to the extent the cost of the renewable energy property was provided by public funds.

e. Credit Availability (G.S. § 105-129.16A(d))

A taxpayer may not claim a credit for renewable energy property under Article 3B if the taxpayer is claiming any other credit allowed in Chapter 105 with respect to renewable energy property. A taxpayer may not take a credit for property the taxpayer leases from another unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to the property.

f. Delayed Sunset (G.S. § 105-129.16A(f))

For most taxpayers, this credit was repealed effective for renewable energy property placed into service on or after January 1, 2016. Taxpayers meeting certain production capacity and project completion requirements were eligible for extension of the credit sunset until January 1, 2017 if they filed an application with the Department of Revenue by October 1, 2015 asserting that the extension criteria would be met, and paid an applicable fee. Taxpayers, along with a licensed engineer and certified public

accountant also were required to provide documentation by March 1, 2016 certifying the percentage completion and cost requirements were met with respect to the renewable energy project.

3. Credit for Constructing Renewable Fuel Facilities (G.S. § 105-129.16D)

a. Credit *(Except as provided in "G.S. § 105-129.16D(b)," repealed effective for facilities placed in service on or after January 1, 2014)*

Either a dispensing credit or a production credit is allowed for the construction of renewable fuel facilities. Either credit is subject to the tax election and cap on credit amount provisions of "G.S. § 105-129.17," the substantiation requirements of "G.S. § 105-129.18," and the requirement in "G.S. § 105-129.19" that the Department report the credits claimed to the Revenue Laws Study Committee and to the Fiscal Research Division of the General Assembly.

b. Renewable Fuel Defined (G.S. § 105-129.15(8))

Renewable fuel is either:

- Biodiesel as defined in "G.S. § 105-449.60."
- Ethanol either unmixed or in mixtures with gasoline that are seventy percent (70%) or more ethanol by volume.

c. Dispensing Credit (G.S. § 105-129.16D(a))

A taxpayer that constructs and installs and places in service in this State a qualified facility for dispensing renewable fuel is allowed a dispensing credit. A facility is qualified if the equipment used to store or dispense renewable fuel is labeled for this purpose and is clearly identified as associated with renewable fuel.

The credit is equal to fifteen percent (15%) of the cost to the taxpayer of constructing and installing the part of the dispensing facility, including pumps, storage tanks, and related equipment, that is directly and exclusively used for dispensing or storing renewable fuel.

The tax credit is claimed in three equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the portion of a facility that is directly and exclusively used for dispensing or storing renewable fuel is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim any carryforwards of any prior years' installments.

d. Production Credit (G.S. § 105-129.16D(b))

A taxpayer that constructs and places in service in this State a commercial facility for processing renewable fuel is allowed a production credit. The credit is equal to twenty-five percent (25%) of the cost to the taxpayer of constructing and equipping the facility. The tax credit is claimed in seven equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the facility is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim carryforwards of any prior years' installments.

e. Alternative Production Credit (G.S. § 105-129.16D(b1))

A taxpayer that constructs and places in service in this State three or more commercial facilities for processing renewable fuel and invests a total amount of at least four hundred million dollars ($400,000,000) in the facilities is allowed a credit equal to thirty-five percent (35%) of the cost of constructing and equipping the facilities in lieu of the production credit allowed in "G.S. § 105-129.16D(b)." To claim the credit, the taxpayer must obtain a written determination from the Secretary of Commerce that the taxpayer is expected to invest, within a five-year period, a total amount of at least four hundred million dollars ($400,000,000) in three or more facilities.

The credit is taken in seven equal annual installments beginning with the taxable year in which the first facility is placed in service. If, in any one of the years in which an installment of the credit is to be claimed, a facility with respect to which the credit is claimed is disposed of or taken out of service and the investment requirements are no longer satisfied, the credit expires and the taxpayer may take any remaining installment of the credit only to the extent allowed under "G.S. § 105-129.16D(b)." The taxpayer may, however, take the portion of an installment of the alternative production credit that accrued in a previous year and was carried forward to the extent permitted under "G.S. § 105-129.17."

Notwithstanding the provisions of "G.S. § 105-129.17(a)," a taxpayer may claim the alternative production credit against corporate income tax only.

f. No Double Credit (G.S. § 105-129.16D(c))

A taxpayer cannot claim the credits allowed under "G.S. § 105-129.16D(b)" and "G.S. § 105-129.16D(b1)" with respect to the same facility. A taxpayer that claims any other tax credit allowed under Chapter 105 with respect to the costs of constructing and installing a renewable energy facility may not take the credits allowed in this section with respect to the same costs.

4. **Credit for Biodiesel Producers (G.S. § 105-129.16F)**
(Repealed for tax years beginning on or after January 1, 2014)

Effective for taxable years beginning on or after January 1, 2008, biodiesel providers that produce at least one hundred thousand (100,000) gallons of biodiesel during the taxable year are allowed a credit equal to the per gallon excise tax the producer paid under Article 36C of Chapter 105. For purposes of this credit, "biodiesel" is defined as "liquid fuel derived in whole from agricultural products, animal fats, or wastes from agricultural products or animal fats."

The credit does not apply to tax paid on diesel fuel included in a biodiesel blend. The maximum annual credit is five hundred thousand dollars ($500,000).

5. **Work Opportunity Tax Credit (G.S. § 105-129.16G)**
(Expired for taxable years beginning on or after January 1, 2014)

A taxpayer who is allowed a federal work opportunity tax credit under Part IV, Subpart F of the Code is allowed to take a credit against its North Carolina corporate income or franchise tax equal to six percent (6%) of the credit allowed under the Code for wages paid during the taxable year for positions located in this State. A position is located in this State if more than fifty percent (50%) of the employee's duties are performed in this State. This section expires for taxable years beginning on or after January 1, 2012.

6. **Credit for Donations to a Nonprofit Organization or Unit of State or Local Government for Acquisition of Renewable Energy Property (G.S. § 105-129.16H)**
(Repealed for renewable energy property placed into service on or after January 1, 2016)

Effective for taxable years beginning on or after January 1, 2008, a taxpayer who donates money to a tax-exempt nonprofit organization or a unit of State or local government for the purpose of providing funds for the organization or government unit to construct, purchase, or lease renewable energy property is allowed a credit under this section if the donation is used for its intended purpose. The amount of the credit is equal to the taxpayer's proportionate share of the credit the nonprofit organization or government unit could have taken under "G.S. § 105-129.16A" if the nonprofit organization or government unit were subject to tax.

The credit must be taken in the taxable year the property is placed in service. The installment requirement for nonresidential property in "G.S. § 105-129.16A" does not apply. The nonprofit organization or government unit must provide each taxpayer who made a donation a statement describing the property, setting out the cost of the property, the amount of the credit the organization or government unit could claim if it were subject to tax, and the taxpayer's share of the credit. A taxpayer claiming a credit under this section may not deduct this donation as a charitable contribution.

5. Historic Rehabilitation Tax Credits (Article 3D)

1. General Information

This Article expired for qualified expenditures incurred on or after January 1, 2015 and was replaced with a new historic rehabilitation credit in "Article 3L."

a. Tax Credited (G.S. § 105-129.37(a))

The credits provided in this Article are allowed only against income tax.

b. Credit Limitations (G.S. § 105-129.37(b))

A credit allowed may not exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

A credit must be taken in five equal installments beginning with the taxable year in which the property is placed in service. Any unused portion of a credit may be carried forward for the succeeding five years.

c. Form

"Form D-400TC" is used to report any tax credits taken under this Article. This form must be filed for any taxable year in which a credit or an installment of a credit against the taxpayer's tax liability for that year is taken.

2. Credit for Rehabilitating Income-Producing Historic Structure (G.S.§ 105-129.35)

a. Credit (G.S. § 105-129.35(a))

A taxpayer that is allowed a federal income tax credit under section 47 of the Code for making qualified rehabilitation expenditures for a certified historic structure located in North Carolina is allowed a State income tax credit equal to twenty percent (20%) of the expenditures that qualify for the federal credit. The tax credit is forty percent (40%) of qualifying expenditures if the certified historic structure is a facility that at one time served as a State training school for juvenile offenders.

b. Allocation (G.S. § 105-129.35(b) and (c))

Notwithstanding the provisions of "G.S. § 105-131.8" and "G.S. § 105-269.15," a pass-through entity that qualifies for the credit may allocate the credit among any of its owners at its discretion as long as an owner's adjusted basis in the pass-through entity, as determined under the Code, at the end of the taxable year in which the certified historic structure is placed in service, is at least forty percent (40%) of the amount of credit allocated to that owner. Owners to whom a credit is allocated are allowed the

credit as if they had qualified for the credit directly. A pass-through entity and its owners must include a statement of the allocation made by the pass-through entity and the allocation that would have been required under "G.S. § 105-131.8" or "G.S. § 105-269.15" with their tax returns for every taxable year in which an allocated credit is claimed. A pass-through entity includes a Subchapter S corporation, a limited liability company, a limited partnership, a general partnership and a joint venture. An owner of a pass-through entity is an individual or entity who is treated as an owner under the federal tax laws.

c. Forfeiture for Disposition (G.S. § 105-129.37(c))

A taxpayer who is required under section 50 of the Code to recapture all or part of the federal credit for rehabilitating an income-producing historic structure located in this State forfeits the corresponding part of the State credit allowed with respect to that historic structure. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allowed.

d. Forfeiture for Change in Ownership (G.S. § 105-129.37(d))

If an owner of a pass-through entity that has qualified for the credit allowed disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the rehabilitated historic structure is placed in service and the owner's interest is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the historic structure was placed in service, the owner forfeits a portion of the credit. The amount forfeited is determined by multiplying the amount of credit by the percentage reduction in ownership and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code. The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

e. Exceptions to Forfeiture (G.S. § 105-129.37(e))

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.

f. Liability from Forfeiture (G.S. § 105-129.37(f))

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate

established under "G.S. § 105-241.21," computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the taxes and interest by the due date is subject to penalties as provided in "G.S. § 105-236."

g. Substantiation (G.S. § 105-129.35(a))

A taxpayer claiming this credit must attach to the return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has been properly rehabilitated.

3. Credit for Rehabilitating Nonincome-Producing Historic Structure (G.S. § 105-129.36)

a. Credit (G.S. § 105-129.36(a))

A taxpayer that is not allowed a federal income tax credit under section 47 of the Code and who incurs rehabilitation expenses for a non-income producing State-certified historic structure is allowed a credit against North Carolina income tax.

The amount of the credit is thirty percent (30%) of the rehabilitation expenses taken in five equal installments beginning with the taxable year in which the property is placed in service. The tax credit is forty percent (40%) of qualifying expenditures if the certified historic structure is a facility that at one time served as a State training school for juvenile offenders.

Rehabilitation expenses do not include the cost of acquiring the property, site work, personal property or cost attributable to the enlargement of the existing property.

b. Eligibility (G.S. § 105-129.36(a))

To qualify for the credit, the taxpayer's rehabilitation expenses must exceed twenty-five thousand dollars ($25,000) within a twenty-four-month period.

c. Substantiation (G.S. § 105-129.36(a))

To claim the credit, a taxpayer must attach to the return a copy of the certification issued by the State Historic Preservation Officer.

6. Credit for Mill Rehabilitation (Article 3H)

This Article expires January 1, 2015 for rehabilitation projects for which an application is submitted on or after such date. Eligibility certifications for this Article expire January 1, 2023. For more information, please see "Credit for Rehabilitating Historic Mill Facility".

1. General Information (G.S. § 105-129.73(a))

A taxpayer that places eligible rehabilitated mill property into service is allowed a credit against either franchise tax, income tax, or gross premiums tax. The taxpayer must elect the tax against which the credit is being claimed when filing the return on which the credit is claimed. The election is binding and any installments or carryforwards of the credit must be claimed against the same tax.

a. Cap on credit (G.S. § 105-129.73(b))

The credit cannot exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by or on behalf of the taxpayer. Any unused credit may be carried forward for the succeeding nine years.

b. Coordination with Article 3D (G.S. § 105-129.74)

A taxpayer claiming a credit under this Article cannot also claim a credit under Article 3D with respect to the same activity. The authority given to the North Carolina Historical Commission in Article 3D to establish rules and fees also applies to this Article.

c. Form

"Form D-400TC" is used to report any tax credits taken under this Article. This form must be filed for any taxable year in which a credit or an installment of a credit against the taxpayer's tax liability for that year is taken.

2. Credit for income-producing rehabilitated mill property (G.S. § 105-129.71)

a. Credit (G.S. § 105-129.71(a))

A taxpayer that is allowed a federal income tax credit under Code section 47 for making qualified rehabilitation expenditures of at least three million dollars ($3,000,000) with respect to a certified rehabilitation of an eligible site is allowed a State credit equal to a percentage of the expenditures that qualify for the federal credit. The credit may be claimed in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenditures associated with the phase placed in service during that year.

To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is:

- Forty percent (40%) of the qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of the eligibility certification.
- Thirty percent (30%) of the qualified expenditures if the eligible site is located in a tier four or five area on the date of the eligibility certification.

b. Allocation (G.S. § 105-129.71(b))

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least forty percent (40%) of the amount of credit allocated to that owner. This differs from the allocation principles in "G.S. § 105-131.8" and "G.S. § 105-269.15" that apply to all other tax credits.

Under the general allocations provisions in "G.S. § 105-131.8" and "G.S. § 105-269.15," tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership must have a substantial economic effect, which means that the allocation agreement must reflect the economic interests of the partners in the partnership and cannot be based solely on tax consequences.

A statement of the allocation made under the special provision for this credit and the allocation that would have been required if this provision were not law must be included with the tax returns filed by the pass-through entity and the owners for each year in which the allocated credit is claimed.

c. Forfeiture for change in ownership (G.S. § 105-129.71(c))

The owner of a pass-through entity must forfeit a portion of the credit for rehabilitating income-producing mill property if the owner disposes of more than one-third of the owner's interest in the pass-through entity within five years from the date the eligible site is placed in service. The forfeiture amount is determined by multiplying the amount of the credit by the percentage reduction in ownership and then multiplying that product by the federal recapture percentage found in Code section 50(a)(1)(B).

d. Exceptions to forfeiture (G.S. § 105-129.71(d))

Forfeiture is not required if the change in ownership is the result of:

- The death of the owner, or
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to

the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

e. Liability from forfeiture

An owner of a pass-through entity that forfeits a credit for change in ownership is liable for all past taxes avoided as the result of claiming the credit, plus interest at the rate established under "G.S. § 105-241.21" computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty days after the date the credit is forfeited. If the taxes and interest are not paid by the due date, the taxpayer is subject to the penalties in "G.S. § 105-236."

3. Credit for nonincome-producing rehabilitated mill property (G.S. § 105-129.72)

a. Credit (G.S. § 105-129.72(a))

A taxpayer that is not allowed a federal income tax credit under Code section 47 and that makes qualified rehabilitation expenses of at least three million dollars ($3,000,000) with respect to a certified rehabilitation of an eligible site is allowed a State tax credit equal to a percentage of the rehabilitation expenses. The credit may be claimed in five equal installments beginning in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenses associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is forty percent (40%) of qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of the eligibility certification. No credit is allowed if the eligible site is in a tier four or five area.

b. Allocation (G.S. § 105-129.72(b))

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least forty percent (40%) of the amount of credit allocated to that owner. This differs from the allocation principles in "G.S. § 105-131.8" and "G.S. § 105-269.15" that apply to all other tax credits. Under the general allocation provisions, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership must have a substantial economic effect, which means that the allocation agreement must reflect the economic interests of the partners in the partnership and cannot be based solely on tax consequences. A statement of the allocation made under the special provision for this credit and the allocation that would have been required if this provision were not law must be

included with the tax returns filed by the pass-through entity and the owners for each year in which the allocated credit is claimed.

c. Forfeiture for change in ownership (G.S. § 105-129.72(c))

If an owner of a pass-through entity disposes of more than one-third of the owner's interest in the pass-through entity within five years from the date the eligible site is placed in service, the owner must forfeit a portion of the credit for rehabilitating nonincome-producing mill property. The forfeiture amount is determined by multiplying the amount of the credit by the percentage reduction in ownership and then multiplying that product by the federal recapture percentage found in Code section 50(a)(1)(B). The remaining allowable credit is allocated equally among the five years in which the credit is claimed.

d. Exceptions to forfeiture (G.S. § 105-129.72(d))

Forfeiture is not required if the change in ownership is the result of:

- The death of the owner, or
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

e. Liability from forfeiture (G.S. § 105-129.72(e))

An owner of a pass-through entity that forfeits a credit for change in ownership is liable for all past taxes avoided as the result of claiming the credit, plus interest at the rate established under "G.S. § 105-241.21" computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due thirty (30) days after the date the credit is forfeited. If the taxes and interest are not paid by the due date, the taxpayer is subject to the penalties provided in "G.S. § 105-236."

7. Tax Credits for Growing Businesses (Article 3J)

Article 3J was repealed effective for business activities occurring on or after January 1, 2014.

For more information, see "Guidelines for Article 3J Tax Credits ."

8. Tax Incentive for Railroad Intermodal Facility (Article 3K)

1. Credit (G.S. § 105-129.96)

A taxpayer that constructs or leases an eligible railroad intermodal facility in this State and places it in service during the tax year is allowed a tax credit equal to fifty percent (50%) of amounts paid by the taxpayer towards the cost of construction or under the lease. The credit may not exceed fifty percent (50%) of the tax against which it is claimed. Any unused portion of a credit may be carried forward for ten years.

2. Taxes Credited (G.S. § 105-129.96)

The credit is allowed against either income or franchise tax. The taxpayer must elect the tax against which the credit is claimed when filing the return on which the credit is first claimed. This election is binding. Any carryforwards of the credit must be taken against the same tax.

3. Definitions (G.S. § 105-129.95)

a. **Costs of Construction.** The costs of acquiring and improving land, constructing buildings and other structures, equipping the facility, and constructing and equipping rail tracks to the railroad intermodal facility that are necessary to access and support facility operations. In the case of property owned or leased by the taxpayer, cost is determined pursuant to regulations adopted under section 1012 of the Code.

b. **Eligible railroad intermodal facility.** A railroad intermodal facility for which the costs of construction exceed thirty million dollars ($30,000,000).

c. **Intermodal facility.** A facility where freight is transferred from one mode of transportation to another.

d. **Railroad intermodal facility.** An intermodal facility whose primary purpose is to transfer freight between a railroad and another mode of transportation.

4. Substantiation (G.S. § 105-129.97)

Any taxpayer claiming this credit must maintain adequate records to determine and verify the amount of the credit and must make these records available for inspection by the Secretary. The burden of proving eligibility and the amount of the credit rests upon the taxpayer. No credit will be allowed to any taxpayer that fails to maintain adequate records or to make them available for inspection.

5. **Reports (G.S. § 105-129.98)**

The Department must publish a report showing the number of taxpayers claiming this credit, the amount of the credit claimed and the tax against which the credit is claimed, and the total cost to the General Fund no later than May 1 of each year.

6. **Sunset (G.S. § 105-129.99)**

This Article is repealed effective for taxable years beginning on or after January 1, 2038.

9. Historic Rehabilitation Tax Credits (Article 3L)

1. General Information

This Article replaces "Article 3D" credits and is effective for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2016.

a. Tax Credited (G.S. § 105-129.108(a))

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

b. General Credit Limitations (G.S. § 105-129.108(c))

A credit allowed may not exceed the amount of tax against which it is claimed for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer. A taxpayer claiming a credit under "Article 3L" may not also claim a credit under "Article 3D" or "Article 3H" with respect to the same activity.

Any unused portion of a credit may be carried forward for the succeeding nine (9) years.

c. Forms (G.S. § 105-129.108(b))

A taxpayer must claim the historic rehabilitation tax credit on the tax return filed for the 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 credit or a carryover of a 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 credit is based on the expenditure amount associated with the phase placed into service during the respective tax year.

d. Rules and Fees (G.S. § 105-129.107)

The North Carolina Historical Commission, in consultation with the State Historic Preservation Officer, may adopt rules to administer "Article 3L" and a schedule of fees, not to exceed 1% of the completed qualifying rehabilitation expenditures.

e. Sunset (G.S. § 105-129.110)

"Article 3L" expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2020.

2. Credit for Rehabilitating Income-Producing Historic Structure (G.S. § 105-129.105)

a. Credit (G.S. § 105-129.105(a))

A taxpayer who is allowed a federal income tax credit under section 47 of the Internal Revenue Code for making qualified rehabilitation expenditures for a certified historic structure located in North Carolina is allowed a 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 year immediately preceding the date the eligibility certification was made.

For purposes of the credit, the terms "qualified rehabilitation expenditures" and "certified historic structure" have the same meaning as under section 47 of the Code, and an "eligibility certification" is a certification obtained from the State Historic Preservation Officer, defined in "G.S. § 105-129.105(c)(7)."

b. Credit Limitation (G.S. § 105-129.105(d))

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

c. 2014 and 2015 Expenses (G.S. § 105-129.105(e))

Expenditures that were incurred in taxable years prior to taxable year 2016 generally do not qualify for this credit. Expenditures incurred in 2014 and 2015 will qualify for this credit if all of the following conditions are met:

(1) The certified historic structure is located in a Tier 1 or Tier 2 county.
(2) The certified historic structure is owned by a city.
(3) The qualified rehabilitation activity commenced in 2014.
(4) A certificate of occupancy is issued on or before December 31, 2015.
(5) The taxpayer meets all of the other conditions in G.S. 105-129.105.

d. Allocation from Pass-Through Entity (G.S. § 105-129.105(b))

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

The credit for rehabilitating an income-producing historic structure is claimed in the taxable year in which the property is placed in service. When an income-producing property is placed in service in two or more phases in different years, the amount of credit that may be claimed in a year is the amount based on the qualified rehabilitation expenditures associated with the phase placed in service during that year. Any unused portion of the credit may be carried forward for the succeeding nine years.

e. Forfeiture for Disposition (G.S. § 105-129.108(d))

A taxpayer who is required under section 50 of the Code to recapture all or part of the federal credit for rehabilitating an income-producing historic structure located in this State forfeits the corresponding part of the State credit allowed with respect to that historic structure. If the credit was allocated among the owners of a pass-through entity, the forfeiture applies to the owners in the same proportion that the credit was allowed.

f. Forfeiture for Change in Ownership (G.S. § 105-129.108(e))

If an owner of a pass-through entity that has qualified for the credit allowed disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the rehabilitated historic structure is placed in service and the owner's interest is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the historic structure was placed in service, the owner forfeits a portion of the credit. The amount forfeited is determined by multiplying the amount of credit by the percentage reduction in ownership and then multiplying that product by the forfeiture percentage. The forfeiture percentage equals the recapture percentage found in the table in section 50(a)(1)(B) of the Code.

g. Exceptions to Forfeiture (G.S. § 105-129.108(f))

Forfeiture for change in ownership is not required if the change in ownership is the result of any of the following:

- The death of the owner.
- A merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the taxpayer under applicable State law, to the extent the taxpayer does not receive cash or tangible property in the merger, consolidation, or other similar transaction.

h. Liability from Forfeiture (G.S. § 105-129.108(g))

A taxpayer or an owner of a pass-through entity that forfeits a credit under this section is liable for all past taxes avoided as a result of the credit plus interest at the rate established under "G.S. § 105-241.21," computed from the date the taxes would have been due if the credit were not allowed. The past taxes plus interest are due 30 days from the date the credit is forfeited. A taxpayer or owner of a pass-through entity that fails to pay the taxes and interest by the due date is subject to the penalties provided in "G.S. § 105-236."

i. Substantiation (G.S. § 105-129.108(h))

A taxpayer claiming this credit must provide any information required by the Secretary, including filing with the tax return a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has met the rehabilitation requirements of Article 3L, and a copy of the eligibility certification if the historic structure is located in an eligible targeted investment site and the targeted investment bonus is claimed. A taxpayer must also maintain and make available for inspection by the Secretary all records necessary to determine and verify the amount of credit claimed.

3. Credit for Rehabilitating Nonincome-Producing Historic Structure (G.S. § 105-129.106)

a. Credit (G.S. § 105-129.106(a))

A taxpayer that is not allowed a federal income tax credit under section 47 of the Code and who incurs rehabilitation expenses of at least 10 thousand dollars for a non-income producing State-certified historic structure is allowed a credit equal to 15% of the rehabilitation expenses.

"Rehabilitation expenses" are expenses incurred in the certified rehabilitation of a certified historic structure added to the property's basis and incurred without 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)(7)," as contributing to the historic significance of a National Register Historic District or locally district certified by the U.S. Department of the Interior.

b. Limitations (G.S. § 105-129.106(b))

The amount of credit allowed for rehabilitation expenses for a non-income producing historic structure may not exceed $22,500 per discrete property parcel, as defined in "G.S. § 105-129.106(c)(2)." A taxpayer that is the transferee of a State-certified historic structure with rehabilitation expenses is only allowed a credit if the transfer occurs before the structure is placed in service. In such a case, the transferee is the only taxpayer that may claim the credit. The date a property is placed in service is the later of the date on which the rehabilitation is completed or the date in which the property is used for its intended purpose.

A taxpayer can only claim a credit for rehabilitating a nonincome-producing historic structure once during any five year period, not including carryovers.

c. Substantiation (G.S. § 105-129.108(h))

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

XIII. Subject: Statute of Limitations and Federal Determinations

1. General

The law contains 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 return for the purpose of determining the applicable statute of limitations. The date the return which contains sufficient information upon which to determine the tax liability is filed is the determining date.

For more information on the statute of limitations, see "G.S. § 105-241.8" and "G.S. § 105-241.9."

2. Federal Determinations (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)

If the amount of a taxpayer's federal adjusted gross income or federal tax credit that affects the amount of State tax payable is corrected or otherwise determined by the federal government, the taxpayer must file a North Carolina return or amended return reflecting the corrected or determined adjusted gross income or federal tax credit that affects the amount of State tax payable within six months from the date the report was received. If a taxpayer fails to report the federal changes within six months, 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 taxpayer also forfeits the right to any refund due by reason of the federal determination.

Under "G.S. § 105-241.10," if the taxpayer timely files a return or amended return to report the federal changes, the Department may assess additional tax that results only from adjustments related to the federal determination if the tax year is otherwise barred by statute.

3. Statute of Limitations for Refunds (G.S. § 105-241.6) (G.S. § 105-241.7)

The Department of Revenue will refund an individual income tax overpayment of $1.00 or more if the statute of limitations has not expired. A refund of less than $1.00 will not be made unless the taxpayer files a written request for a refund. The general statute of limitations for filing a claim for refund of overpayment of taxes is three years after the due date of the return or two years after payment of the tax, whichever is later. The following exceptions apply:

(a) If a taxpayer files a timely return reflecting a federal determination, 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.

(b) 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.

(c) For overpayments attributable to worthless debts or securities, the period of time for demanding a refund is seven years.

(d) 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.

(e) Overpayments attributable to a contingent event or an event or condition other than a contingent event. For more information, see "Exception to the General Statute of Limitations for Certain Events."

(f) Overpayments attributable to the exclusion of income from wrongful incarceration. If the exclusion of income applies to a tax year that is barred by the general statute of limitations for requesting a refund, the refund may be allowed if the claim for refund was filed by December 18, 2016.

4. Protective Refund Claim

The Department's protective refund claim policy was repealed effective January 1, 2014. If you filed a protective refund claim prior to January 1, 2014, see "Exception to the General Statute of Limitations for Certain Events."

5. Statute of Limitations for Assessments (G.S. § 105-241.8)

The general statute of limitations for proposing an assessment is three years after the due date of the return or three years after the return was filed, whichever is later. The following exceptions apply:

(a) 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 proposed assessment must be made within three years after the date the Department received the final report of the federal determination.

(b) 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.

(c) 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.

There is no statutory provision prohibiting an assessment for a given year after an assessment has already been proposed for that year. Subsequent assessments can be made upon the discovery of new facts.

6. Limit on Refunds and Assessments after a Federal Determination (G.S. § 105-241.10)

When a taxpayer files a timely 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. A federal determination is a correction or final determination by the federal government of the amount of a federal tax due.

7. Appeals Process

1. General (G.S. § 105-241.11)

Taxpayers who disagree with a proposed assessment of taxes or a denied or reduced refund may request that the Department review that 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 mailed by the Department (if mailed) or delivered to you (if delivered by a Department employee in person). For more information, see "Resolving Disputes about Your Taxes."

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

2. Denial of Refund Based on Statute of Limitations (G.S. § 105-241.7(c1))

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 requesting a refund, there is no administrative review of that decision. 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 of refund. The sole issue to be decided by the administrative law judge is whether or not 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."

8. Federal Determinations and Fraud (G.S. 105-236 (a)(6)) (17 NCAC 06B .3206) (17 NCAC 06B .3404)

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

9. Collection of Tax (G.S. § 105-241.22)

The Department may collect a tax in the following circumstances:

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

(2) 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.

(3) When a taxpayer and the Department agree on a settlement concerning the amount of tax due.

(4) 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.

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

(6) When the Office of Administrative Hearing 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.

10. Servicemembers Civil Relief Act

Certain sections of the Servicemembers Civil Relief Act (formerly the Soldiers' and Sailors' Civil Relief Act of 1940) 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 tax was caused by military service. No penalty or interest shall accrue during the period of deferment.

11. Combat Zone

An individual serving in the Armed Forces, or serving in support of the Armed Forces, in an area designated by the President as a combat zone, who receives an extension of time to file his or her 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.

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

12. Waiver of Time Limitation (17 NCAC 01C .0307)

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.

XIV. Subject: Penalties, Interest, and Required Filing of Information Returns

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.

2. Failure to File and Failure to Pay Penalties (G.S. § 105-236) (17 NCAC 06B .3203)

Under the provisions of "G.S. § 105-236," both the late filing and late payment penalties can be applied for the same month. If the 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.

Returns filed after the due date are subject to a failure to file penalty 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). If the 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.

The late payment penalty is 10% of the tax not paid by the original due date of the return. If a timely extension is filed, the penalty will apply on any remaining balance due if the tax paid by the original 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 late payment penalty. Interest is due from the original due date to the date paid.

The late payment penalty will not be assessed if the amount shown due on an amended return is paid with the return. Proposed assessments of additional tax due are subject to the 10% late payment penalty if payment of the tax is not received within 45 days of the assessment unless a timely Request for Departmental Review is filed. For more information on requests for reviews, see "**Appeals Process**."

3. Large Tax Deficiency and Negligence Penalties (G.S. 105-236(a)(5)) (17 NCAC 06B .3204) (17 NCAC 06B .3404)

When there is an understatement of taxable income equal to 25% or more of gross income, the 25% large individual income tax deficiency or other large tax deficiency penalty will be assessed. When the percentage of understatement of taxable income is less than 25%, the 10% negligence penalty may be applied. 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 the accuracy penalty has been assessed for federal income tax purposes, the 10% negligence penalty will be assessed for State 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.

4. Failure to Report Federal Changes (G.S. § 105-159) (G.S. § 105-236)

When a taxpayer fails to report federal changes 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.

5. Fraud (17 NCAC 06B .3206)

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. 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.

6. Collection Assistance Fee (G.S. § 105-243.1)

Any tax, penalty, and interest not paid within 90 days after the tax debt becomes collectible is subject to a 20% collection assistance fee. The fee will not apply if payments are being made pursuant to an installment agreement that became effective within 90 days after the debt became collectible.

7. Interest (G.S. § 105-241.21)

Interest accrues on tax not paid by the original due date even though a taxpayer may have an extension of time for filing the return. Interest accrues on overpayments 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. The law requires the Secretary of Revenue 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."

8. Underpayment of Estimated Income Tax (G.S. § 163.15) (17 NCAC 06D .0201)

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".

9. Waiver of Penalty or Interest (G.S. § 105-237)

Penalties may be waived by the Secretary of Revenue pursuant to the Department of Revenue penalty policy. As a general rule, interest cannot be waived or reduced. However, interest may be waived or reduced if it has accrued on taxes imposed 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. A request for waiver or reduction of penalty generally must be in writing and must include an explanation for the request. When the request is based on the reason of good compliance, a request to waive a penalty can be made by telephone.

To review the Department's "Penalty Waiver Policy," click "here."

XV. Subject: Miscellaneous

1. When a payment is received by the Department of Revenue 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 of Revenue and will not prevent the collection of the correct balance due.

2. 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. For more information, see "G.S. § 8-45.3"

3. 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 "Chapter 105A of the North Carolina General Statutes."

4. 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. For more information, see "G.S. § 105-269.5."

5. 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, 6331 Mail Service Center, Raleigh, North Carolina 27699-6331. 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."

6. An individual may elect to have an income tax refund applied to estimated income tax for the following year. For example, an individual due a refund on the 2016 income tax return may have all or any portion of the refund applied to his estimated tax for 2017. The individual may not, however, file a 2016 tax return in 2018 and request the refund be applied to 2018 estimated tax since the refund can only be applied to the tax year which follows the year for which the request for refund is made. The last allowable date for making a 2017 estimated tax payment is January 15, 2018; therefore, you must file your 2016 income tax return by January 15, 2018, to elect to apply a portion of your refund to 2017 estimated tax. For more information, see "G.S. § 105-269.4."

If an individual makes a valid election, that individual may not revoke the election in order to have the amount refunded or applied in any other manner, such as an offset against any subsequently determined tax liability.

7. 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. For more information, see "G.S. § 105-251(a)."

8. 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. For more information, see "17 NCAC 06B .3906."

9. North Carolina use tax is due by individuals and businesses on tangible personal property and certain digital property purchased, leased or rented inside or outside this State for storage, use, or consumption in North Carolina. Use tax is also due on taxable services sourced to North Carolina. Individuals and businesses must pay use tax to the Department when retailers or facilitators do not collect sales or use tax on taxable transactions.

Retailers or facilitators that are not "engaged in business" in this State are not required to collect North Carolina's tax. Some out-of-state retailers or facilitators voluntarily collect North Carolina use tax as a convenience to their customers. Retailers or facilitators that are not "engaged in business" may include mail-order companies, television shopping networks, and firms selling over the internet. For more information, see "G.S. § 105-164.6."

Filing Requirements:

- An individual required to file a North Carolina individual income tax return, "Form D-400," must report the use tax liability on non-business purchases of taxable items, other than a boat, an aircraft, and food subject to the reduced rate of tax, on the income tax return.

- An individual not required to file Form D-400 must report the use tax liability on taxable purchases, other than a boat or an aircraft, on "Form E-554," Consumer Use Tax Return.

- Any individual who purchases food subject to the reduced rate of tax must report the 2% tax on "Form E-554," Consumer Use Tax Return.

- An individual who purchases a boat or an aircraft must report the tax on "Form E-555," Boat and Aircraft Use Tax Return.

- A business must report use tax on the applicable form. A business that is registered to remit sales and use tax with the Department can file and pay the tax online using the Department's "Online Filing and Payment" system. A business not registered with the Department to remit sales and use tax, may register online using the Department's "Online Business Registration" portal.

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. For more information, see "17 NCAC 06B .0119."

11. **Community Property.** If a married couple is domiciled in a state or country recognized for federal income tax purposes as a community property state or country and the spouses file separate North Carolina returns 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 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 income tax return. For more information, see "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 tax

purposes under "G.S. § 105-266.2". For more information, see "federal Publication 525" and the North Carolina Individual Income Tax Instructions ("Form D-401"). 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."

XVI. Subject: Withholding of Income Tax (Article 4A)

1. General

G.S. §105-163.1 through G.S. § 105-163.10 and G.S. § 105-163.22 through G.S § 163.24 require employers to withhold income tax from compensation paid to their employees.

2. Withholding From Wages (G.S. § 105-163.2)

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 the booklet, "Form NC-30," Income Tax Withholding Tables and Instructions for Employers.

3. Withholding from Pensions, Annuities, and Deferred Compensation (G.S. § 105-163.2A)

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.

b. Definitions (G.S. § 105-163.2A(a))

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

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

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

c. Amount to Withhold (G.S. § 105-163.2A(c))

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 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), 4% of the distribution must be withheld. A nonperiodic distribution includes an eligible rollover distribution as defined in Code section 3405(c)(3). State law differs from federal law with respect to eligible rollover distributions. 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.

d. Election Not to Have Income Tax Withheld (G.S. § 105-163.2A(d))

A recipient may elect not to have income tax withheld from a pension payment unless the pension payment is an eligible rollover distribution as defined in Code section 3405(c)(3). A recipient of a pension payment that is an eligible rollover distribution does not have the option of electing not to have State tax withheld from the distribution.

Except for eligible rollovers, a recipient of a pension payment who has federal income tax withheld can elect not to have State income tax withheld. Conversely, a recipient who has State income tax withheld can elect not to have federal income tax withheld.

An election not to have tax withheld from a pension payment remains in effect until revoked by the recipient. An election not to have 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 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.

e. Exceptions to Withholding (G.S. § 105-163.2A(e))

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:

   (a) It is not a distribution or payment from an individual retirement plan as defined in section 7701 of the Code.

(b) 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."

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 $8,750 that no State 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 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 number. The registration can be completed "online," or by completing "Form NC-BR," Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery, and Equipment, and Manufacturing Fuel Tax. The payer will be assigned an account identification number and will receive forms for paying the State tax withheld. The payer will initially be classified as a quarterly filer. The filing frequency may change after the first year depending on the amount of 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 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. They will receive separate forms for paying the tax withheld from pensions.

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 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 Business Registration Unit. The payer must continue to report the two types of withholding together until the payer receives the separate account identification number and remittance forms 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

Payers must report pension income and State tax withheld on Federal Form 1099-R, "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc." Form 1099-R must be given to the recipient on or before January 31 following the calendar year in which the pension payments were made. The payer must file with the Department "Form NC-3," Annual Withholding Reconciliation, which reconciles the amounts withheld from each recipient. Payers choosing to report pension withholding with wage withholding must file one annual reconciliation report that includes the two types of withholding. Payers subject to both wage withholding and pension withholding that report the two types of withholding separately at any time during the year must file separate annual reconciliations for each type of withholding. The annual reconciliation for withholding from pensions is due on or before January 31.

4. Withholding From Nonresidents for Certain Personal Services and Withholding on Contractors Identified by an Individual Taxpayer Identification Number (ITIN) (G.S. § 105-163.3)

b. General

North Carolina income tax is required to be withheld from non-wage compensation paid to nonresidents for certain personal services rendered in this State. North Carolina tax is also required to be withheld from nonwage compensation paid to an Individual Taxpayer Identification Number (ITIN) holder for services performed in this State. The requirement to withhold applies to payers who, in the course of a trade or business, pay more than $1,500 of non-wage compensation to:

1. A nonresident individual or to a nonresident entity for services performed in this State in connection with a performance, an entertainment or athletic event, a speech, or the creation of a film, radio, or television program, or

2. An ITIN holder for services performed in this State.

These payers must withhold North Carolina income tax at the rate of 4% from the compensation.

Payers are exempt from the requirement to withhold if the compensation is paid to an alien, as described by 8 U.S.C. § 1101(a)(15)(H)(ii)(a), that is not subject to federal income tax withholding under section 1441 of the Code. These aliens are commonly referred to as H-2A agricultural workers. The description of "alien" in 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."

A payer shall consider a contractor as an ITIN holder if the contractor's taxpayer identification number is an ITIN or the contractor does not provide a taxpayer identification number. An ITIN is a nine-digit individual taxpayer identification number. The first digit in an ITIN is 9. For ITINs issued before April 12, 2011, the fourth and fifth digits had a range of 70-88. For ITINs issued on or after April 12, 2011, the range of the fourth through ninth digits includes 70-0000 through 88-9999, 90-0000 through 92-9999, and 94-0000 through 99-9999.

For more information, see "Departmental Directive PD-10-1."

c. Examples of required withholding from compensation paid to a nonresident or ITIN contractor for services performed

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

Example 1. A payer pays an ITIN contractor $900 in January 2017, and does not expect to make any future payments to the ITIN contractor.

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

Example 2. The payer from Example 1 pays the same ITIN contractor $800 in September 2017.

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

Example 3. A payer pays an ITIN contractor $1,000 in January 2017, and expects to make future payments to the same contractor 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 contractor for the year is expected to equal or exceed $1,500.

Example 4. 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 5. The same nightclub owner from Example 4 enters into a contract with an agent to locate an entertainer and also enters into a separate contract with the entertainer.

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 6. 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 has not provided a personal service to the coliseum. The promoter is required to withhold the tax from the compensation paid to the nonresident performer because the entertainer is providing a personal service for the promoter.

5. Wages (G.S. § 105-163.1(13))

For North Carolina income tax purposes, the term wages has the same meaning as in Section 3401 of the Internal Revenue Code.

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.

6. Employee's Withholding Allowance Certificate (G.S. § 105-163.5) (17 NCAC 06C .0123) (17 NCAC 06C .0126)

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-4EZ by February 15 each year. State and federal definitions of dependent, 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 Allowance 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 zero allowances.

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 as follows:

Payroll Period	Weekly	Biweekly	Semimonthly	Monthly
Additional Withholding	$9	$19	$20	$41

If the nonresident alien's wages for the pay period exceed the amount in the chart below for the payroll period, the employee must request the employer to withhold the additional amount in the above chart. If the wages do not exceed the amount in the chart below, the employer must withhold 5.599% of the wages instead of the amount on line 2. If a nonresident alien employee fails to furnish Form NC-4 NRA, the employer must withhold tax as if the employee is single with zero allowances and withhold the additional amount from the above chart.

Payroll Period	Weekly	Biweekly	Semimonthly	Monthly
Wages	$168	$336	$364	$729

(**Note:** Students and business apprentices who are residents of India and subject to the U.S. – India tax treaty may enter $0 on line 2.)

The employer is not required to ascertain whether or not 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 of Revenue 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.

7. Additional Withholding Allowances (G.S. § 105-163.5) (17 NCAC 06C .0124)

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 standard deduction and for each $2,500 of adjustments reducing income.

8. Penalty

"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.

9. Submission of Certain Withholding Allowance Certificates (17 NCAC 06C .0126)

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 North Carolina standard deduction for an individual with a filing status of single divided by 52. For tax year 2017, that amount is $168.27.

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.

10. Employers

An employer is any person or organization for whom an individual performs any service as an employee. 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. (See "G.S. § 105-163.4")

11. Employees (17 NCAC 06C .0107)

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. 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.

12. Employer-Employee Relationship (17 NCAC 06C .0108)

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.

13. Ministers (G.S. 105-163.1A)

An ordained or licensed clergyman who performs services for a church of any religious denomination may file an election with the Secretary of Revenue 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.

14. Common Carriers

The Amtrak Reauthorization and Improvement Act of 1990 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, the compensation received by such nonresident employees 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 USCS-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 this state would be based on the percentage that the North Carolina flight time is to the total flight time for the year.

15. Federal Employees

Under an agreement with this State, 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.

16. Military Spouses

Under the Servicemembers Civil Relief Act, as amended by the Military Spouses Residency Relief Act of 2009, 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:

(1) the servicemember is present in North Carolina solely in compliance with military orders;

(2) the spouse is in North Carolina solely to be with the servicemember; and (3) the spouse is domiciled in the same state as the servicemember. Therefore, if a military spouse meets all three of the preceding conditions, an employer is not required to withhold North Carolina tax from wages paid to such military spouses. The military spouse shall 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 have been met. The military spouse shall 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 Act does not exempt military spouses who are domiciled in North Carolina from North Carolina income tax withholding. Withholding from wages paid to military spouses domiciled

in North Carolina is still required. For more information, see "Active Military" and "Frequently Asked Questions about the Military Spouses Residency Relief Act of 2009."

17. Seamen (17 NCAC 06C .0112)

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 come under the restriction; however, any seaman who is employed in coastwide trade between ports in this State 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 who are exempt from withholding as specified above, should determine whether they meet the requirements for making payments of estimated income tax.

18. Professional Athletes (17 NCAC 06B .3905)

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 this State 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 this State shall determine their filing and paying requirements in the same manner as all employers domiciled in this State.

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 team and the team has met the withholding requirements above. The individual may file an individual income tax return and claim credit for the tax withheld.

The professional athletic team, as well as the individual, shall be personally and individually liable for any additional 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.

19. Domestic/Household Employees

Employers are not required to withhold State income tax from the wages of domestic/household employees; however, the employer and employee may enter into a voluntary agreement to withhold 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. Employers may wish to contact the Division of Employment Security regarding any employment insurance liability.

20. 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 Nonresidents for Certain Personal Services and Withholding on Contractors Identified by an Individual Taxpayer Identification Number (ITIN)." Note: An exception exists for aliens commonly referred to as H-2A agricultural workers.

21. North Carolina State Lottery Winnings (G.S. § 105-163.2B)

Winnings of $600 or more paid by the North Carolina State Lottery Commission are subject to State withholding at the rate of 5.499% for tax year 2017.

22. Supplemental Wage Payments (17 NCAC 06C .0117)

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

(a) Withhold a flat 5.599% for tax year 2017, or

(b) Add the supplemental and regular wages for the most recent payroll period and then figure the income tax as if the total were a single payment. Subtract the tax already withheld from the regular wages and withhold the remaining tax from the supplemental wages.

Note. If the employer does not withhold income tax from the employee's regular wages, use method (b).

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

Tips treated as supplemental wages. The employer shall withhold the income tax on tips from wages or collect the tax from funds the employee provides. If an employee receives regular wages and reports tips, the employer shall figure income tax as if the tips were supplemental wages. If the employer has not withheld income tax from the regular wages, the employer adds the tips to the regular wages and withholds income tax on the total. If the employer withheld income tax from the regular wages, the employer can withhold on the tips as previously explained.

23. Wage and Tax Statements (17 NCAC 06C .0119)

An employer should use the six-part federal Form W-2 or any other alternate forms which have been designed for payroll equipment if they provide the same information and the same number of copies as the official form. When completed, the state copies must show the employer's North Carolina withholding identification number and must clearly designate the state tax as North Carolina tax. Statements which do not meet the above requirements will not be accepted and employees cannot be given credit for the tax withheld.

24. Reciprocity of Tax Credits (17 NCAC 06C .0120)

North Carolina does not allow income tax credit to nonresidents; therefore, any relief from double taxation must be granted by the state of residence. North Carolina provides such relief to its residents. For more information, "Tax Credits."

25. 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, 2016, will be allowed credit for tax withheld from wages for the calendar year ending December 31, 2015. This is the case even though the taxpayer must report the income on the return for the fiscal year ending September 30, 2016.

XVII. Subject: Reporting and Paying Tax Withheld

1. New Employers (17 NCAC 06C .0201)

Each new employer required to withhold North Carolina income tax must "register online" or complete and file "Form NC-BR," Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery and Equipment Tax. 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 employer from whom a business was acquired.

2. Reports and Payments (G.S. § 105-163.6)

North Carolina does not use a deposit system for income tax withheld similar to the federal system. Withheld taxes are paid quarterly, monthly, or semiweekly. Employers who withhold an average of less than $250 from wages 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.

Employers who withhold an average of at least $250 but less than $2,000 from wages 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 by the thirty-first day of January.

Employers who withhold an average of at least $2,000 from wages each month must file a report and pay the withheld taxes at the same times they are required to file reports and pay the tax withheld on the same wages 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 an employer is required to deposit federal employment taxes, the employer must remit the North Carolina income tax withheld on those same wages, regardless of the amount of State tax withheld.

Exception. For federal tax purposes, if an employer 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 is due on or before the normal federal semiweekly due date for those wages. The employer 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," North Carolina Income Tax Withholding Return. The due dates for Form NC-5Q are the same as for the federal quarterly return (federal Form 941). An employer has 10 additional days to file the return if all required payments were made during the quarter and no additional tax is due. An employer 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.

For information on when a document is considered timely filed, see "Departmental Directive TA-16-1."

3. E-File

Employers can file their North Carolina withholding returns and pay their taxes online by using the Department's "Online Filing and Payments" portal. The E-file system is available 24 hours a day, 7 days a week. Payments can be made by bank draft or credit or debit card using Visa or MasterCard.

4. Electronic Funds Transfer (G.S. 105-241(b)(3)) (17 NCAC 01C .0504)

The Department requires certain employers remitting an average of $20,000 per month per tax type to pay taxes by electronic funds transfer (EFT). Employers required to remit payments by this method will be notified in writing at least 60 days prior to the first month that an EFT payment is due. Voluntary participation is offered for all filing frequencies for non-mandated employers who are interested in paying electronically. For questions concerning electronic funds transfer, contact the EFT Unit at 1-877-308-9103.

5. Amounts Withheld Are Held In Trust For The Secretary Of Revenue. (G.S. § 105-163.8) (17 NCAC 06C .0204)

Any amount withheld by an employer is deemed to be held in trust for the Secretary of Revenue.

A penalty of 10% 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.

An employer 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 an employer has failed to withhold or to pay over income tax withheld or required to have been withheld, the unpaid principal amount of tax may be assessed against the responsible persons of the employer. The liability includes only the tax not deducted or paid. The liability does not include any penalties and interest previously assessed against the employer.

More than one person may be liable as a person responsible for the payment of withholding taxes; however, the amount of the income tax withheld or required to have been withheld shall be collected only once, whether from the employer or one or more responsible persons. 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 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 a partner who is liable for the debts and obligations of a partnership under "G.S. § 59-45" or "G.S. § 59-403." It is not necessary that the failure to collect and pay the withholding amounts was willful; it is only necessary that the responsible person failed to pay the tax withheld or required to have been withheld to the Secretary of Revenue.

When the Department of Revenue determines that collection of the tax is in jeopardy, an employer may be required to report and pay the tax at any time after payment of the wages.

8. Annual Reports (G.S. § 105-163.3) (G.S. § 105-163.7) (17 NCAC 06C .0203)

At the end of each calendar year, employers must furnish wage and tax statements, Form W-2, to employees. Two copies shall be furnished to the employee and one copy shall be furnished to the Department. The Internal Revenue Service supplies a six-part Form W-2 which will produce the required federal and North Carolina statements in one packet.

The copies of the wage and tax statements for the Department must be filed with "Form NC-3," Annual Withholding Reconciliation, on or before January 31 following the calendar year and in an electronic format as prescribed by the Secretary. For more information, see the Department's "eNC3" portal.

A payer who withholds from compensation paid to a nonresident contractor or ITIN contractor must provide the contractor a statement showing the total compensation paid and the amount withheld during the calendar year. The payer must give "Form NC-1099PS," Personal Services Income Paid To A Nonresident, or "Form NC-1099-ITIN," Compensation Paid to an ITIN Contractor, to the contractor on or before January 31 following the calendar year or, if the contractor requests the statement before then, within 45 days after the last payment of compensation to the contractor. Federal Form 1099-MISC may be filed in lieu of Form NC-1099PS or Form NC-1099-ITIN.

"Form 1099NRS," Report of Sale of Real Property by Nonresidents, must be filed by any person buying real property located in North Carolina from a nonresident. The form must be filed within 15 days of the closing date of the sale.

A payer who withholds from pension income must give the recipient federal Form 1099-R, showing the pension amount paid and the North Carolina tax withheld on or before January 31 following the year in which the pension payments were made.

Forms NC-1099PS, NC-1099-ITIN, NC-1099NRS, and federal Forms W-2G and 1099-R must be filed with North Carolina, whether or not North Carolina income tax has been withheld. Other reports of 1099 information (interest, rents, premiums, dividends, etc.) are not required to be reported to North Carolina unless the payments have not been reported to the Internal Revenue Service.

XVIII. Subject: Estimated Income Tax (G.S. 105-163.15)

1. Forms

"Form NC- 40" is the form for payment of estimated individual income tax. Form NC-40 is a four-part, non-personalized payment form. The four-part form includes the necessary vouchers and instructions for making payments. An individual can pay estimated tax online using the Department's "e-services for individuals" portal.

2. Requirements for Filing (17 NCAC 06D .0102)

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. Married individuals can make joint payments of estimated income tax even if they are not living together; however, they may not make joint estimated tax payments if they are separated under a decree of divorce or of separate maintenance. Also, they 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 payments will not affect their choice of filing a joint income tax return or separate return. If they make joint payments and then file separate returns, they may determine how to divide the estimated tax payments between them.

A taxpayer filing a short period return because of changing his 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. The 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 return and computed in the same manner as it would have been computed had the taxpayer not changed his or her income year.

3. Applying Prior Year's Income Tax Refund to Current Year's Estimated Income Tax

An individual may elect to have his or her income tax refund applied to estimated income tax for the following year. For example, an individual due a refund on his or her 2016 income tax return may have all or any portion of the refund applied to his or her estimated tax for 2017. The individual may not however, file a 2016 tax return in 2018 and request the refund be applied to his or her 2018 estimated tax since the refund can only be applied to the tax year which follows the year for which the request for refund is made. The last allowable date for making a 2017 estimated tax payment is January 15, 2018; therefore, you must file your 2016 income tax return by January 15, 2018, to elect to apply a portion of your refund to 2017 estimated tax. If an individual makes a valid election, that individual may not revoke the election after the return has been filed in order to have the amount refunded or applied in any other manner, such as an offset against any subsequent determined tax liability.

XIX. Subject: Interest on the Underpayment of Estimated Income Tax (G.S. 105-163.15)

1. General (17 NCAC 06D .0201)

Interest may be due on the underpayment of estimated income tax. The 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.

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:

1. 90% (66.67% for farmers and fishermen) of the tax (after tax credits) on the current year's return,

2. 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

3. 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.

Also, 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 (17 NCAC 06D .0207)

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 and 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.

4. Overpayments (17 NCAC 06D .0208)

An overpayment for any period occurs when the withholding and estimated 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 tax paid for that later period to determine any underpayment or overpayment for that later period.

5. Determining an Underpayment (17 NCAC 06D .0209)

No interest will be due if the estimated 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 return or 25% of the tax shown on the prior-year 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 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.

6. Period of Underpayment (17 NCAC 06D .0210)

Underpayment interest is applied to the number of days that the installment was not paid. For tax year 2016, 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, 2017, 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, 2017.

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.

7. Farmers and Fishermen

The following special rules for underpayment of estimated tax apply to farmers and fishermen:

a. Interest for underpaying 2016 estimated tax will not apply if the return was filed and all tax was paid by March 1, 2017. 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 2016 estimated tax will be determined from one payment due date, January 15, 2017.

c. Underpayment interest for 2016 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 2015 return or 66.67% of the 2016 tax.

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.

XX. Subject: 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".