

April 4, 2023

Important Notice: Session Law 2023-12 Includes Retroactive Benefits that May Help Taxpayers Preparing 2022 Tax Returns

The following important information is addressed in this notice:

- An explanation of how specific provisions of Session Law 2023-12 affect 2022 North Carolina individual income and partnership tax returns (collectively, “NC Tax Returns”).
- Instructions on how to file a NC Tax Return for tax year 2022 if the provisions of Session Law 2023-12 affect you.
- Instructions on how to file an amended NC Tax Return for tax year 2022 if the provisions of Session Law 2023-12 affect you and you previously filed a NC Tax Return.

Background

On April 3, 2023, Governor Roy Cooper signed [Session Law 2023-12](#) (Senate Bill 174). This legislation includes several key provisions that enhance North Carolina’s recently enacted pass-through entity (“PTE”) tax,¹ including several provisions that affect the 2022 NC Tax Returns that are due during this filing season. The purpose of this notice is to provide an overview of these key retroactive changes.

Expanded Taxed Partnership Eligibility

Prior to the enactment of Session Law 2023-12, [N.C. Gen. Stat. § 105-154.1\(a\)](#) did not allow a partnership to make the Taxed Partnership election if it had, at any time during the taxable year, a partner who was not one of the following:

- (1) An individual.
- (2) An estate.
- (3) A trust described in section 1361(c)(2) of the Code.
- (4) An organization described in section 1361(c)(6) of the Code.

Session Law 2023-12 expanded the list of eligible partners by adding new subdivision (5) to N.C. Gen. Stat. §105-154.1(a) that reads as follows:

- (5) A partnership including an entity that is classified as a partnership for federal income tax purposes, or an S Corporation as defined in N.C. Gen. Stat. § 105-131(b).

As a result of the new law, a partnership is **NOT** disqualified from being a Taxed Partnership if one (or more) of its partners is a partnership or an S Corporation (collectively, a “Pass-Through

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

Partner”). This means that an eligible partnership² owned by a Pass-Through Partner can make the election to be a Taxed Partnership for tax year 2022.

Although an eligible partnership owned by a Pass-Through Partner can make the Taxed Partnership election for tax year 2022, the Taxed Partnership **cannot** include the Pass-Through Partner’s distributive share of North Carolina taxable income when the Taxed Partnership calculates its North Carolina taxable income.³ Instead, the Taxed Partnership must comply with the requirements of [N.C. Gen. Stat. § 105-154\(d\)](#) with respect to a nonresident Pass-Through Partner and must pass the Pass-Through Partner’s distributive share of North Carolina taxable income to the Pass-Through Partner.⁴ For more information on nonresident partners, see [North Carolina Personal Taxes Bulletin, Taxable Year 2022, section VI.8](#).

Changes to the Instructions for the 2022 NC Partnership Return

The 2022 NC Partnership Tax Return (“[Form D-403](#)”) and associated instructions (“[Form D-403A](#)”) were issued in January 2023. To assist a Taxed Partnership owned by a Pass-Through Partner with filing Form D-403 for tax year 2022, the Department is providing the following updates:

1. [2022 Form D-403A, Page 9 - Demographic and Other Taxpayer Information](#)
An eligible partnership owned by a Pass-Through Partner can make the election to be a Taxed Partnership for tax year 2022. To make the election, the partnership **MUST** answer “Yes” to the “Taxed Partnership” question located on page 1 of Form D-403. If the partnership does not answer “Yes” to the question, the partnership is **NOT** a Taxed Partnership for tax year 2022.
2. [2022 Form D-403A, Pages 9 and 10 - Part 1. Informational Return and Tax Due for Nonresident Partners or Taxed Partnership](#)

Line 11. Under the new law, a Taxed Partnership owned by a Pass-Through Partner must determine the amount of tax due to report on Line 11 by calculating the North Carolina taxable income for the following types of partners:

- A resident partner that is **NOT** a Pass-Through Partner, and
- A nonresident partner that is **NOT** a Pass-Through Partner, and
- A nonresident Pass-Through Partner if the partner does not execute an affirmation (“[Form NC-NPA](#)”) agreeing to timely file and pay North Carolina income tax on the partner’s distributive share of North Carolina taxable income.

For more information on how to calculate North Carolina tax due for each type of partner, see the updates for Part 4, on page 3 of this notice.

² See SB 174, s. 1.5.(b); [S.L. 2023-12](#). See also N.C. Gen. Stat. §§ [105-153.3\(13\)](#) and [105-154.1\(a\)](#).

³ See SB 174, s. 1.5.(c); [S.L. 2023-12](#).

⁴ See SB 174, s. 1.5.(a); [S.L. 2023-12](#).

3. [2022 Form D-403A](#), Pages 12 and 13 - **Part 4. Partner Information and Tax Calculation for Nonresident Partners and Taxed Partnerships**

- A. Partner's Share of Income, Adjustments, Tax Credits, and Other Items. A Taxed Partnership must complete Lines 1 through 8 for **each** partner, including all Pass-Through Partners.
- B. North Carolina Taxable Income for Nonresident Partners. A Taxed Partnership must complete Lines 9 through 17 for **each** nonresident partner, including any nonresident Pass-Through Partner.⁵
- C. Net Tax Due for Nonresident Partners on Whose Behalf the Partnership Pays the Tax. A Taxed Partnership must complete Lines 18 through 20 for **each** nonresident Pass-Through Partner that did not execute a [Form NC-NPA](#).

Important: If the Taxed Partnership does not answer "Yes" to the "NC-NPA Form Attached" question located under Line 20 for each nonresident Pass-Through Partner, the Department may assess the Taxed Partnership additional income tax based on the North Carolina taxable income of each nonresident partner reported on Line 17.

- D. Partners' Share of Taxed Partnership's Tax Credits and Other Items. A Taxed Partnership must complete Lines 21 through 23 for **each** partner, including all Pass-Through Partners.
 - E. Taxed Partnership's North Carolina Taxable Income for Nonresident Partners. A Taxed Partnership must complete Line 24 for **each** nonresident partner that is **NOT** a Pass-Through Partner.
 - F. Taxed Partnership's North Carolina Taxable Income for Resident Partners. A Taxed Partnership must complete Lines 25 through 28 for **each** resident partner that is **NOT** a Pass-Through Partner.
 - G. Taxed Partnership's Net Tax Due. A Taxed Partnership should complete Lines 29 through 32 as instructed on Form D-403, with the noted changes described above.
4. [2022 Form D-403A](#), Pages 14 and 15 – **Part 1. Tax Credits Not Subject to 50% of Tax Limit**

Line 10. As noted above, under the new law, a Taxed Partnership is required to complete Form D-403, Part 4, Line 18, for each nonresident Pass-Through Partner that does not execute a Form NC-NPA, and Form D-403, Part 4, Line 30, for each resident partner and nonresident partner that is not a Pass-Through Partner.

⁵ To determine whether a corporation, LLC, or partnership is a nonresident of North Carolina, see [North Carolina Personal Taxes Bulletin, Taxable Year 2022, section VI.8](#).

If a Taxed Partnership is required to complete Part 4, Line 18 and Line 30, **AND** the Taxed Partnership claims a tax credit that is not subject to the 50% of tax limitation on Form D-403TC,⁶ the Taxed Partnership must enter on Form D-403TC, Line 10, the Partners' Total from Form D-403, Part 4, Line 18 **AND** Line 30.

5. [2022 Form D-403 NC K-1](#), **Part C. Taxed Partnerships Only**

Because the Taxed Partnership is not allowed to include a Pass-Through Partner's distributive share of North Carolina taxable income in the Taxed Partnership's calculation of North Carolina taxable income, the Taxed Partnership cannot complete Part C for a Pass-Through Partner. This means that the Pass-Through Partner **IS NOT** allowed to deduct its share of income from the Taxed Partnership on [Form NC-PE](#) when it calculates its North Carolina taxable income.

Expanded Individual Income Tax Credit for Taxes Paid to Another State by a PTE

[N.C. Gen. Stat. § 105-153.9](#) allows an individual who is both a resident⁷ of North Carolina and subject to the income tax laws of another state to claim a tax credit for income taxes paid to the other state if the individual pays the income tax to the other state. [N.C. Gen. Stat. § 105-131.8\(a\)](#) provides a limited exception for a resident shareholder of an S Corporation. Importantly, prior to the enactment of Session Law 2023-12, no corresponding exception was available for a resident partner of a partnership.

Effective for taxable years beginning on or after January 1, 2022, Session Law 2023-12 rewrote [N.C. Gen. Stat. § 105-153.9](#) by adding new subdivisions (d) and (e). In general, these new provisions allow a North Carolina resident individual owner of a partnership or an S Corporation (collectively, a "Resident Owner") to claim the tax credit for taxes paid to another state when the income tax is paid by the partnership or S Corporation.

Specifically, subject to the provisions of newly enacted N.C. Gen. Stat. § 105-153.9(d) and (e), a Resident Owner may claim the credit for income taxes paid to another state by the PTE if:

- The PTE paid income tax to the state (or District of Columbia) and was subject to an entity-level tax levied by the state on the PTE's aggregate share of income allocable to one or more of its Owners; and
- The PTE does not make the election to be a Taxed PTE for North Carolina purposes.

If the PTE meets both requirements, a Resident Owner is considered to have paid the income tax imposed on the Resident Owner in an amount equal to the Resident Owner's share of any income tax paid by the PTE to the other state.⁸

Important: If the partnership or S Corporation makes the election to be a Taxed PTE for North Carolina income tax purposes, the Resident Owner of the Taxed PTE cannot claim the credit for

⁶ See [Form D-403TC, Part 1, Line 9, for tax year 2022](#).

⁷ See [N.C. Gen. Stat. § 105-153.3\(15\)](#).

⁸ See SB 174, s. 1.5.(d); [S.L. 2023-12](#).

taxes paid to another state by the PTE. The allowable tax credit, if any, can only be claimed by the Taxed PTE.

Claiming the Tax Credit for Taxes Paid to Another State by a PTE

In general, a Resident Owner eligible to claim the credit for income taxes paid to another state must complete [Part 1 of Form D-400TC](#) to determine the amount of allowable tax credit.⁹ In addition, the Resident Owner must attach the following information to the Resident Owner's North Carolina individual income tax return ("[Form D-400](#)"):

- A copy of the Resident Owner's individual income tax return(s) filed with the other state (if applicable).
- Proof of payment for income tax paid to the other state. Examples of proof of payment include, but are not limited to, a copy of the Resident Owner's K-1 if the K-1 reflects the Resident Owner's share of taxes paid to the other state, or a sworn statement provided to the Resident Owner by the PTE that reflects the Resident Owner's share of taxes paid to the other state.

Amending a 2022 NC Tax Return

North Carolina Partnership Return ("[Form D-403](#)")

If a partnership has already filed a North Carolina partnership return for tax year 2022 and, under the new law, the partnership is eligible to make the election to be a Taxed Partnership, the partnership must file an amended Form D-403 by the due date of the North Carolina partnership return, including extensions. An election made on an amended return filed after the due date is **NOT** valid.¹⁰

Important: The amended Form D-403 must be completed in accordance with the instructions starting on page 2 of this notice as well as the instructions provided on page 16 of [Form D-403A](#) for tax year 2022.

North Carolina Individual Income Tax Return ("[Form D-400](#)")

If you have already filed a North Carolina individual income tax return for tax year 2022, and, under the new law, you are eligible to claim a tax credit for income taxes paid to another state, you should file an amended Form D-400. If the amended return reflects an overpayment, the amended return must be filed within the [general statute of limitations for obtaining a refund](#).

Important: The amended Form D-400 must be completed in accordance with the instructions starting on page 4 of this notice as well as the instructions provided on page 24 of [Form D-401](#) for tax year 2022.

⁹ For more information, see page 22 of the [2022 D-401, Individual Income Tax Instructions](#).

¹⁰ See [N.C. Gen. Stat. § 105-154.1\(a\)](#).

Future Impacts and Assistance

Additional guidance regarding the impact of Session Law 2023-12 on NC Tax Returns for tax year 2023 will be provided when the Department releases the 2023 instructions for the applicable NC Tax Return.

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

To the extent there is any change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this important notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance regarding the subject of this notice and issued prior to this notice conflict with this important notice, the provisions contained in this important notice supersede the previous guidance.