

State of North Carolina

**FRANCHISE TAX
CORPORATE INCOME TAX
PRIVILEGE TAX
INSURANCE PREMIUM TAX
EXCISE TAX**

2006 SUPPLEMENT

**RULES AND BULLETINS
TAXABLE YEARS 2005 & 2006**

Issues By

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2006 Supplement to Rules and Bulletins for Taxable Years 2005 & 2006

Preface

This publication is a supplement to the Franchise Tax, Corporate Income Tax, Privilege Tax, Insurance Premium Tax, and Excise Tax Rules and Bulletins for Taxable Years 2005 & 2006. This supplement addresses changes to the 2005/2006 Rules and Bulletins resulting from legislative actions, court decisions, Attorney General opinions, rules adopted or amended under the Administrative Procedures Act, Chapter 150B of the General Statutes, or administrative interpretation by the Department of Revenue.

This supplement includes only those sections of the 2005/2006 Rules and Bulletins that have been changed. With one exception, the changes are indicated by striking through the original material and underlining the new material. The exception is the section titled *Quality Jobs and Business Expansion Credits (Article 3A of Chapter 105)*. This section is updated in its entirety each year; therefore, the old material is not struck through and the new material is not underlined.

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I. FRANCHISE TAX (Article 3)

A. General Information (G.S. 105-114)

2. Corporation Defined

For franchise tax purposes, the term “corporation” includes not only corporations in the usual meaning of the term, but also associations, joint stock companies, trusts and other organizations formed or operating for pecuniary gain which have capital stock represented by shares and privileges not possessed by individuals or partnerships. The term ~~does not include~~ a limited liability ~~company~~companies that elect to be taxed as C Corporations for federal income tax purposes. (Change effective for taxable years beginning on or after January 1, 2007 and impacts franchise tax reported on the 2006 corporate income and franchise tax return since franchise tax is for the tax year in which the tax becomes due.

9. Tax Credit for Limited Liability Companies Subject to Franchise Tax

Effective for taxable years beginning on or after January 1, 2007, LLCs that elect to be taxed as C Corporations for federal income tax purposes are allowed a tax credit against franchise tax equal to the difference between the annual report fee on corporations under G.S. 55-1-22 and the annual report fee for limited liability companies under G.S. 57C-1-22(a). The credit allowed may not exceed the franchise tax liability for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

B. Electric Power, Water and Sewerage Companies (G.S. 105-116)

2. Due Date of the Return and Tax

The returns are due quarterly and should contain, in addition to the other information, the total gross receipts from such business in North Carolina for the preceding calendar quarter. The return is due by the last day of the month that follows the quarter covered by the return. Payments by EFT are required if the company is required to pay tax semi-monthly. Payments are due as follows:

a. Electric Power Companies

Effective January 1, 2002, electric power companies must pay their gross receipts franchise tax in accordance with the same schedule by which they pay sales and use taxes on electricity.

A company that consistently remits at least \$10,000 a month in sales and use tax must pay the taxes twice a month. G.S. 105-241(b)(2) requires semi-monthly payments be made by electronic funds transfer.

Companies that remit between \$100 and \$10,000 a month in sales tax pay on a monthly basis, and all other companies pay on a quarterly basis.

The semi-monthly payment that covers the period from the first of the month to the

15th day of the month is due by the 25th of that month. The semi-monthly payment that covers the period from the 16th day to the end of the month is due by the 10th day of the following month.

Monthly payments are due by the 15th day of the month that follows the month the tax accrues.

A company is not subject to interest and penalty on an underpayment for a semi-monthly or monthly payment period if it timely pays at least ninety-five percent (95%) of the amount due for each period and includes the underpayment with the quarterly return for those semi-monthly or monthly payment periods.

Effective October 1, 2007, an electric power company that is consistently liable for less than \$100 per month in franchise tax is required to pay its tax on a quarterly basis. The tax is due at the same time the quarterly return is due.

An electric power company that is consistently liable for at least \$100 per month in franchise tax is required to pay its tax on a monthly basis. The tax is due by the 20th day of the month following the calendar month for which the payment applies.

Additionally, if an electric power company's liability is consistently at least \$10,000 per month, the electric power company must prepay the next month's tax liability at the same time that it is paying the current month's liability. The prepayment must equal at least 65% of any of the following:

- The amount of tax due for the current month.
- The amount of tax due for the same month in the preceding year.
- The average monthly amount of tax due in the preceding calendar year.

b. Water & Sewerage Companies

Companies pay tax quarterly when filing the quarterly return, which is due by the last day of the month that follows the quarter covered by the report.

C. Holding Companies (G.S. 105-120.2)

1. Definition

A holding company is any corporation that receives more than eighty percent (80%) of its gross income during its taxable year from corporations in which it owns, directly or indirectly, more than fifty percent (50%) of the outstanding voting stock or voting capital interest.

If a holding company has an ownership interest in an LLC doing business in the State and the LLC is treated as a C Corporation for federal income tax purposes, the holding company's share of the income of the LLC is included in the denominator and, if the corporation owns more than fifty percent (50%) of the voting capital interest in the LLC, the holding company's share of the income of the LLC is included in the numerator when computing the holding company test.

~~If a holding company has an ownership interest in an LLC doing business in the State and the LLC is treated as a corporation for federal income tax purposes, the holding company's share of the income of the LLC is included in the denominator, but not in the numerator when computing the holding company test.~~

E. General Business Corporations (G.S. 105-122)

3. Corporations Required to File

Unless specifically exempt under G.S. 105-125, all active and inactive domestic corporations, and all foreign corporations with a Certificate of Authority to do business, or which are in fact doing business in this State, are subject to the annual franchise tax levied under G.S. 105-122.

If an LLC is treated as a C Corporation for federal tax purposes and a corporate member's only connection to North Carolina is its ownership interest in the LLC, the corporate member(s) is not required to file a North Carolina corporate income tax return. The corporate member(s) is not required to file in this circumstance because the LLC reports its North Carolina income at the entity level and the apportionment attributes of the LLC do not flow through to the corporate member(s) as is the case when the LLC is disregarded or is treated as a partnership.

If an LLC is treated as a C Corporation for federal tax purposes and a corporate member has activities in this State in addition to its ownership interest in the LLC, the corporate member(s) is required to file a corporate income and franchise tax return.

F. Capital Stock, Surplus and Undivided Profits Base (G.S. 105-122(b) & (c))

1. Bases on the Year End Balance Sheet

This base is determined from the corporation's books and records, as reflected by its balance sheet, used for financial accounting purposes, as of the close of the income year immediately preceding the due date of the return.

2. Surplus Defined

The term "surplus" for franchise tax purposes has a broader and more inclusive meaning than the generally accepted accounting definition. It includes, in addition to the balance sheet surplus, all liabilities, reserves and deferred credits.

3. Items Includable and Excludable

In addition to the items listed on the tax form, include stock subscribed, deferred taxes and all other surplus, reserves, deferred credits, inventory valuation reserves, amounts deferred as result of a LIFO valuation method (LIFO "reserves") and liabilities except reserve for depreciation permitted for income tax purposes, accrued taxes, dividends declared, and definite and accrued legal liabilities. Deferred income resulting from customer advances for goods or services may be excluded from this base provided there exists a definite legal liability to render such service or deliver such goods, no part of such advances has been reported or is reportable for income

tax purposes, and all related costs and expenses are reflected in the balance sheet as assets. Deferred income arising from the usual installment sale is not deductible since the corresponding liability would have been discharged at the time of delivery.

The following items are *excludable* from capital stock, surplus and undivided profits in arriving at the net base:

- a. Cost of treasury stock.
- b. Definite and accrued legal liabilities.
- c. Accrued taxes.
- d. Reserve for depreciation permitted for income tax purposes.
- e. Dividends declared.
- f. Reserves for cost of any air-cleaning device or sewage or waste treatment plant, including waste lagoons, and pollution abatement equipment certified by the Department of Environment and Natural Resources or the Environmental Management Commission. Reserves for cost should be net of any depreciation on the equipment excluded from the base.
- g. Cost of purchasing and installing equipment or constructing facilities for the purpose of recycling or resource recovering of or from solid waste certified by the Department of Environment and Natural Resources. Cost should be net of any depreciation on the equipment and facilities excluded from the base.
- h. Cost of constructing facilities of any private or public utility built for the purpose of providing sewer service to residential and outlying areas. Cost should be net of any depreciation on the facility excluded from the base.
- i. Cost of equipment and facilities acquired for the purpose of reducing the volume of hazardous waste generated. Cost should be net of any depreciation on the equipment and facilities excluded from the base.
- j. If a corporation is, in the opinion of the Secretary of Revenue, qualified under the United States Code Annotated Title 26, Section 851 as a "Regulated Investment Company" or "Real Estate Investment Trust" and elects to be treated as such for North Carolina tax purposes it shall be allowed to exclude the aggregate market value of its investments in stocks, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies, or governments.
- k. All assets of an international banking facility which are employed outside the United States less all liabilities owed to foreign persons by the facility.

1. The corporation's investment in an LLC if the corporation is required to include a percentage of the LLC's income, assets, liabilities, and equity in the corporation's franchise tax calculation under G.S. 105-114.1.

The following items are *includable*:

- a. Capital stock subscribed
- b. Appraisal surplus.
- c. Reserve for bad debts.
- d. Deferred income (except as explained above).
- e. Deferred taxes. liabilities (may be reduced by deferred tax assets, but not below zero. No other deferred liabilities may be reduced by deferred tax assets. Effective for taxable years beginning on or after January 1, 2007.)
- f. Contingent liabilities.
- g. Inventory valuation reserves.
- h. LIFO "reserves."
- i. All other reserves and allocations: also, credit items (not exempted above) that do not represent definite and accrued legal liabilities. The liability must be definite in amount and must be incurred prior to the end of the taxable year. To be definite in amount, the liability must be exactly determined, and not merely accurately estimated.
- j. Percentage of LLC income, assets, liabilities, and equity under G.S. 105-114.1. For additional information on the filing requirements for members of LLCs, see Subsection J "Corporate Members of LLCs" and Item 5, Subsection L "Corporations Conditionally or Partially Exempt" in this section.

J. Corporate Members of LLCs (G.S. 105-114.1)

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

Effective January 1, 2002, a corporation that is a member of a limited liability company (LLC) and is entitled to receive at least seventy percent (70%) of the LLC's assets upon dissolution is required to include a percentage of the LLC's income, assets, liabilities, and equity in the corporation's franchise tax calculation. In that case, the corporation's investment in the LLC is not included in the calculation of the corporation's capital stock, surplus and undivided profits base.

Effective January 1, 2003, if a corporation or affiliated group of corporations owns, directly or constructively, seventy percent (70%) or more of the capital interests in an LLC, the corporation or group of corporations must include the same percentage of the LLC's assets in its three franchise tax bases. The attribution to the three bases is equal to the same percentage of (1) the LLC's capital stock, surplus and undivided profits, (2) fifty-five percent (55%) of the LLC's appraised ad valorem tax value of property, and (3) the LLC's actual investment in tangible property in this State.

Exception – if the total book value of the LLC's assets never exceeds one hundred fifty thousand dollars (\$150,000) during its taxable year, no attribution is required.

Effective January 1, 2005, the ownership percentage that requires an attribution of the LLC's assets is reduced from seventy percent (70%) to fifty percent (50%).

When a partnership, trust, LLC, or other entity is placed between a corporation and an LLC, ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in IRC §318(a)(2)(A) and (B), modified as follows:

- The term “capital interest” is substituted for “stock” where that term appears in the referenced Code section.
- An LLC and any noncorporate entity other than a partnership, estate or trust is treated as a partnership.
- The operating rule of section 318(a)(5) applies without regard to section 318(a)(5)(C).

Example: A partnership owns one hundred percent (100%) of the capital interests of an LLC. Corporation A is a fifty percent (50%) owner of the partnership. Corporation A constructively owns fifty percent (50%) of the capital interest in the LLC.

The members of an affiliated group must determine the percentage of the LLC's assets to be included in each member's franchise tax bases. If all members of the group are doing business in North Carolina, then the percentage of the LLC's assets included by each member in its franchise tax bases is equal to the member's percentage ownership in the LLC. If some of the members of the group are not doing business in North Carolina, then the percentage of the LLC's assets owned by the group are allocated among the members that are doing business in North Carolina. The percentage attributed to each member doing business in North Carolina is determined by multiplying the percentage of the LLC owned by the entire group by a fraction. The numerator of the fraction is the percentage of the LLC owned by the member and the denominator is the total percentage of the LLC owned by all members doing business in North Carolina.

If the owner of the capital interests in a noncorporate LLC is an affiliated group of corporations, the percentage to be included by each member that is doing business in

this State is determined by multiplying the capital interests in the noncorporate LLC owned by the affiliated group by a fraction. The numerator of the fraction is the capital interests of the noncorporate LLC owned by the group member, and the denominator is the capital interests in the noncorporate LLC owned by all group members that are doing business in this State.

Effective for taxable years beginning on or after January 1, 2007, ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in IRC §318(a)(2)(A) and (B), modified as follows:

- The term “capital interest” is substituted for “stock” where that term appears in the referenced Code section.
- A noncorporate LLC and any noncorporate entity other than a partnership, estate, or trust is treated as a partnership.
- The operating rule of section 318(a)(5) of the Code applies without regard to section 318(a)(5)(C).

Example: An affiliated group of corporations own one hundred percent (100%) of the capital interests in an LLC. The group consists of three corporations. Corporation A is doing business in North Carolina and owns fifty percent (50%) of the LLC. Corporation B is doing business in North Carolina and owns ten percent (10%) of the LLC. Corporation C is not doing business in North Carolina and owns forty percent (40%) of the LLC. The percentage of the LLC’s assets required to be included in Corporation A’s and Corporation B’s franchise tax bases is determined as follows:

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

$$\text{Corporation B: } 100\% \times 10\% \div (50\% + 10\%) = 16.67\%$$

A corporation that is required to include a percentage of the noncorporate LLC’s assets in its franchise tax bases may exclude its investment in the noncorporate LLC from its computation of the capital stock base.

Shifting assets back and forth between a corporation and ~~an~~ a noncorporate LLC to avoid franchise tax is prohibited. Ownership of the capital interests in ~~an~~ a noncorporate LLC is determined as of the last day of the noncorporate LLC’s taxable year. The attribution of the noncorporate LLC’s assets and the exclusion of the corporation’s investment in the noncorporate LLC are made to the corporation’s next following franchise tax return. However, if the corporation and noncorporate LLC engage in a pattern of transferring assets between them so that each did not own the assets on the last day of its taxable year, the ownership of the capital interest in the noncorporate LLC must be determined as of the last day of the corporation’s taxable year.

Any taxpayer who, because of fraud with intent to evade tax, underpays the tax under this Article (G.S. 105 Article 3) is guilty of a Class H felony in accordance with G.S. 105-236(7). For additional information on the filing requirements for members of

LLCs, see Item 5, Subsection L “Corporations Conditionally or Partially Exempt” in this section.

L. Corporations Conditionally or Partially Exempt (G.S. 105-122, G.S. 105-125)

5. Limited Liability Company (LLC)

The “North Carolina Limited Liability Company Act” (Chapter 57C of the North Carolina General Statutes) permits the organization and operation of limited liability companies (LLC). An LLC is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership. ~~Limited Noncorporate limited~~ liability companies are not subject to the franchise tax. A noncorporate limited liability company is an LLC that does not elect to be taxed as a C Corporation under the Code.

Each corporate member of an LLC doing business in North Carolina has nexus in North Carolina, however, not every corporate member is required to file North Carolina corporate income and franchise tax returns. The determining factors are the LLC’s entity classification and each corporate member’s other activities in this State.

If an LLC is treated as a partnership for federal income tax purposes, each corporate member is required to file a corporate income and franchise tax return even if there are no other activities in the State since the LLC’s income, assets, and activities flow through to the members of the LLC. The treatment of a corporate member of an LLC that is treated as a partnership is identical to the treatment of a corporation that is a partner in a partnership.

If the LLC is treated as a corporation for federal tax purposes and each corporate member’s only connection to North Carolina is its ownership interest in the LLC, the corporate member(s) is not required to file a North Carolina corporate income and franchise tax return even though the corporate member(s) has nexus in North Carolina as a result of its membership in the LLC. The corporate member(s) is not required to file in this circumstance because the LLC reports its North Carolina income at the entity level and the apportionment attributes of the LLC do not flow through to the corporate member(s) as is the case when the LLC is disregarded or is treated as a partnership.

If the LLC is treated as a corporation for federal tax purposes and each corporate member has activities in this State, in addition to its ownership interest in the LLC, that make the corporate member subject to the franchise tax, the corporate member(s) is required to file a corporate income and franchise tax return.

Effective for taxes due January 1, 2002, through December 31, 2002, a corporation that is a member of an LLC and is entitled to receive at least seventy percent (70%) of the LLC’s assets upon dissolution, must include the LLC’s assets in the corporation’s investment in tangible property franchise tax base. The member

corporation's investment in the LLC is excludible from the computation of the corporation's capital stock, surplus and undivided profits base. (G.S. 105-114(c)).

Effective for any taxes due on or after January 1, 2003, the income, assets, liabilities, or equity of an LLC are attributed to a corporation or affiliated group of corporations if the corporation or affiliated group of corporations owns, directly or constructively, seventy percent (70%) or more of the LLC's assets. Constructive ownership can exist when a partnership, trust, LLC, or other entity is placed between a corporation and an LLC. In such situations, ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in IRC §318(a)(2)(A) and (B), modified as follows:

- The term "capital interest" is substituted for "stock" where that term appears in the referenced Code section.
- An LLC and any noncorporate entity other than a partnership, estate, or trust is treated as a partnership.
- The operating rule of section 318(a)(5) applies without regard to section 318(a)(5)(C).

Effective January 1, 2005, the ownership percentage that requires an attribution of the LLC's assets is reduced from seventy percent (70%) to fifty percent (50%).

Effective for taxable years beginning on or after January 1, 2007, ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in IRC §318(a)(2)(A) and (B), modified as follows:

- The term "capital interest" is substituted for "stock" where that term appears in the referenced Code section.
- A noncorporate LLC and any noncorporate entity other than a partnership, estate, or trust is treated as a partnership.
- The operating rule of section 318(a)(5) of the Code applies without regard to section 318(a)(5)(C).

An example of the attribution calculation is included in Subsection J "Corporate Members of LLCs" in this section. The member corporation's actual investment in the LLC is excludible from the member corporation's computation of its capital stock, surplus and undivided profits base.

II. CORPORATE INCOME TAX (Article 4)

C. Computation of Net Income (G.S. 105-130.3, G.S. 105-130.5)

2. Adjustments to Federal Taxable Income

The following *additions* to Federal taxable income must be made in determining State net income:

- a. Taxes based on or measured by net income by whatever name called and excess profits taxes.
- b. Interest paid in connection with income exempt from State income taxation. (See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property.")
- c. The contributions deduction allowed by the Internal Revenue Code.
- d. Interest income earned on bonds and other obligations of other states or their political subdivisions, less allowable amortization on any bond acquired on or after January 1, 1963.
- e. The amount by which gains have been offset by the capital loss carryover allowed under the Internal Revenue Code. All gains recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.
- f. The net operating loss deduction allowed by the Internal Revenue Code.
- g. Payments to or charges by a parent, subsidiary or affiliated corporation in excess of fair compensation in all intercompany transactions of any kind whatsoever.
- h. The amount of all income tax credits claimed against the corporation's income tax liability during the income year. In lieu of the add-back of tax credits to federal taxable income, taxpayers must now reduce the amount of credit available by the current income tax rate. (See Form CD-425, Part 4, Line 26.)
- i. Percentage depletion in excess of cost depletion applicable to mines, oil and gas wells and other natural deposits located outside this State.
- j. The amount allowed under the Code for depreciation or as an expense in lieu of depreciation for a utility plant acquired by a natural gas local distribution company, to the extent the plant is included in the company's rate base at zero cost in accordance with G.S. 62-158.

- k. Royalty payments for the use of intangible property in this State made to a related member and deducted as an expense by a payer in arriving at federal taxable income if the election is made under G.S. 105-130.7A for the recipient to exclude the royalty income from its income. Intangible property is defined as copyrights, patents, and trademarks. A taxpayer is not required to add back royalty payments for the use of intangible property in this State made to a related recipient that is organized under the laws of another country if the country has a comprehensive income tax treaty with the United States and imposes a tax on royalty income of the recipient at a rate that is equal to or exceeds the State's corporate income tax rate. (See G.S. 105-130.7A(b)(4) and (5) for definitions of related members.) (Change effective for taxable years beginning on or after January 1, 2006.)
- l. The applicable percentage of the amount allowed as a special accelerated depreciation deduction under section 168(k) or section 1400L of the Code. For taxable years beginning on or after January 1, 2003, the applicable percentage is seventy percent (70%). For taxable years beginning on or after January 1, 2005, the applicable percentage is zero percent (0%).
- m. The gross income from international shipping activities excluded from federal taxable income because the corporation elects to be subject instead to a tonnage tax under Subchapter R of Chapter 1 of the Code. (Effective for taxable years beginning on or after January 1, 2005).
- n. The gross income from domestic production activities excluded from federal taxable income under Section 199 of the Code. (Effective for taxable years beginning on or after January 1, 2005).
- o. Qualifying expenses for which a film or television production credit is claimed under G.S. 105-130.47. (Effective for taxable years beginning on or after January 1, 2005, and applies to qualifying expenses incurred on or after July 1, 2005.) (Repealed effective for taxable years beginning on or after January 1, 2007.)

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

- a. Interest upon the obligations of the United States or its possessions, to the extent included in federal taxable income. However, interest upon obligations of the United States shall not be an allowable deduction unless interest upon obligations of the State of North Carolina or any of its political subdivisions is exempt from income tax imposed by the United States. See subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property.")

- b. Interest (net of expenses) received from obligations of the State of North Carolina, a political subdivision of this State, a commission, authority, or another agency of this State, and a nonprofit educational institution organized or chartered under the laws of this State to the extent included in federal taxable income.
- c. Payments received from a parent, subsidiary, or affiliated corporation in excess of fair compensation in intercompany transactions which in the determination of the net income or net loss of such corporation were not allowed as a deduction under this State's revenue laws.
- d. Dividends treated as received from sources outside the United States, as determined under section 862 of the Code, net of related expenses, to the extent included in federal taxable income. The netting of related expenses shall be calculated in accordance with G.S 105-130.5(c)(3) and G.S. 105-130.6A.
- e. Any amount included in federal taxable income under section 78 or section 951 of the Code, net of related expenses.
- f. Net economic losses incurred by the corporation in any or all of the fifteen (15) preceding years pursuant to the provision of G.S. 105-130.8. For specific instructions with respect to net economic loss determination and requirements applicable to multistate corporations, see Subject: "Net Economic Loss Carry-Over."
- g. Contributions or gifts made by the corporation within the income year to the extent provided under G.S. 105-130.9. (See Subject: "Deduction of Contributions.")
- h. Amortization in excess of depreciation allowed for Federal income tax purposes on the cost of sewage, waste or air pollution facilities; recycling and resource recovering facilities; or hazardous waste disposal facilities as provided in G.S. 105-130.10. (See Subject: "Rapid Amortization of Air or Water Pollution Abatement, Recycling and Resource Recovering, Sewage, and Hazardous Waste Facilities.")
- i. Depreciation of emergency facilities acquired prior to January 1, 1955. Any corporation shall be permitted to depreciate any emergency facility, as defined in section 168 of the Internal Revenue Code in effect prior to 1976, over its useful life, provided such facility was acquired prior to January 1, 1955, and no amortization has been claimed on such facility for State income tax purposes.
- j. The amount of losses realized on the sale or other disposition of assets not allowable under section 1211(a) of the Internal Revenue Code. All losses recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.

- k. The portion of undistributed capital gains of regulated investment companies included in Federal taxable income and on which the Federal tax paid by the regulated investment company is allowed as a credit or refund to the shareholder under section 852 of the Internal Revenue Code.
- l. The amount by which a deduction for an ordinary and necessary business expense on the corporation's federal income tax return was reduced and not allowable as a deduction because the corporation claimed in lieu of such amount a tax credit against its federal income tax due for the income year.
- m. Reasonable expenses, in excess of deductions allowed for federal income tax purposes, paid for reforestation and cultivation of commercially grown trees, except that the deduction shall be allowed only to those corporations whose real owners are natural persons actively engaged in the commercial growing of trees, or the spouse, siblings, or parents of such persons. In no case shall a corporation be allowed a deduction for the same cultivation or reforestation expenditure more than once.
- n. The amount by which the basis of a depreciable asset has been reduced on account of a tax credit allowed for federal tax purposes.
- o. Market assessments paid by the corporation on tobacco grown in North Carolina.
- p. The amount of natural gas expansion surcharges collected by a natural gas local distribution company under G.S. 62-158.
- q. The amount of 911 service charges collected under G.S. 62A-5 and remitted to a local government under G.S. 62A-6, and the amount of wireless Enhanced 911 service charges collected under G.S. 62A-23 and remitted to the Wireless Fund under G.S. 62A-24, to the extent included in federal taxable income.
- r. Any interest, investment earnings, and gains of a trust established by two or more manufacturers that signed a settlement agreement with N.C. to settle claims for damages attributable to a product of the manufacturers, if the trust meets all of the conditions set forth in G.S. 105-130.5(b)(18).
- s. Hurricane relief or assistance payments made to taxpayer by the Office of State Budget, Planning, and Management from the Hurricane Floyd Reserve Fund to the extent included in federal taxable income. Compensation paid from the Fund to the taxpayer for goods or services is **not** deductible.
- t. Royalty payments received for the use of intangible property in this State by a recipient from a payer that is a related member, if the election is made under G.S. 105-130.7A for the payer to exclude the royalty payments from its

expenses deduction. Intangible property is defined as copyrights, patents and trademarks. (See G.S. 105-130.7A~~(b)(4) and (5)~~ for definitions ~~of related members.~~) (Change effective for taxable years beginning on or after January 1, 2006.)

- u. In each of the taxpayer's first five taxable years beginning on or after January 1, 2005, an amount equal to twenty percent (20%) of the amount added to taxable income in a previous year as accelerated depreciation under G.S. 105-130.5(a)(15). For pass-through entities, the deduction is available only to the taxpayer that reported the addition in arriving at taxable income.
- v. To the extent included in federal taxable income, the amount received from the Disaster Relief Reserve Fund in the Office of State Budget and Management for hurricane relief or assistance. This deduction does not include payments for goods or services provided by the taxpayer. (Effective for taxable years beginning on or after January 1, 2004.)

Other adjustments to Federal taxable income that must be made in determining State net income are listed below:

- a. In determining State net income, no deduction shall be allowed for annual amortization of bond premiums applicable to any bond acquired prior to January 1, 1963. The amount of premium paid on any such bond shall be deductible only in the year of sale or other disposition.
- b. Federal taxable income must be increased or decreased to account for any difference in the amount of depreciation, amortization, or gains or losses applicable to property that has been depreciated or amortized by use of a different basis or rate for State income tax purposes than used for Federal income tax purposes.
- c. No deduction is allowed for any direct or indirect expenses related to income not taxed, except no adjustment is made under this subsection for adjustments addressed in G.S. 105-130.5(a) and (b) and in G.S. 105-130.6A. (See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property.")
- d. Federal taxable income must be adjusted in instances where the taxable income change caused by the recovery of previously deducted amounts may be different for state income tax purposes.
- e. A saving and loan association may deduct interest earned on deposits at the Federal Home Loan Bank of Atlanta to the extent included in federal taxable income.

D. Interest Income on Government Obligations (G.S. 105-130.3, G.S. 105-130.5)

4. Sales or Exchanges (17 NCAC 05C.0404)

Gain or loss realized on the sale or other disposition of any type of obligation of the United States or its possessions, the State of North Carolina ~~(which are not exempted by the specific obligation)~~ or its political subdivisions, any other state or its political subdivisions, or of any other government is a taxable transaction and must be included in the computation of a corporation's State taxable income.

Gain or loss realized on the sale or other disposition of obligations issued before July 1, 1995 is not included in taxable income if North Carolina law under which the obligations were issued specifically exempts the gain ~~or interest~~ from taxation.

Example 1: Interest on bonds, notes, debentures or other evidence of the indebtedness issued under G.S. 131E-28 by the North Carolina Hospital Authorities, including gain from the sale or exchanges of these obligations.

Example 2: Interest and gain derived from obligations issued by the North Carolina Housing Finance Agency under G.S. 122A-19.

Example 3: Interest and gain derived from bonds issued under the Joint Municipal Electric Power and Energy Act under G.S. 159B-26.

Example 4: Interest on bonds, notes, debentures, or other evidence of indebtedness issued by the North Carolina Medical Care Commission under the Health Care Facilities Finance Act under the provisions of G.S. 131A-21. Gain from the sale or exchange of these obligations *may* also be excludible.

Example 5: Interest and gain on bonds issued by the North Carolina State Ports Authority under G.S. 143B-456(g).

Example 6: Interest on bonds, notes, debentures, and any other evidence of indebtedness issued by a North Carolina Housing Authority (including any corporate agent authorized by Article 1 of Chapter 157 of the General Statutes to exercise the powers of the authority) under the provisions of G.S. 157-26. Gain from the sale or exchange of these obligations *is not* excludible.

Example 7: Interest on bonds issued by the authorities created under the Industrial and Pollution Control Facilities Financing Act, G.S. 159C-14.

Example 8: Income from securities, evidence of indebtedness, and shares of capital stock issued by a corporation to promote, develop, and advance the prosperity and economic welfare of the State of North Carolina under the provisions of G.S. 53A-15. Gain from the sale or exchange of such obligations is excludible.

Example 9: Income from bonds issued by boards of trustees of State supported colleges and universities in North Carolina including any gain from the sale or exchange of such bonds under G.S. 116-183 and G.S. 116-196.

Example 10: Interest and gain received from bonds and notes issued under the provision of the Higher Education Facilities Act by the North Carolina Educational Facilities Finance Agency under G.S. 115E-21.

Example 11: Interest and gain received on obligations issued under Chapter 122D (the North Carolina Agriculture Finance Act) by the North Carolina Agriculture Finance Authority under G.S. 122D-14.

J. Deduction of Contributions (G.S. 105-130.9(1), (2), (3) and (4))

6. Contributions When Taxpayer Claims Tax Credit (G.S. 105-130.9(4))

A amount of a contribution for which a taxpayer claims a tax credit for certain real property donations (G.S. 105-130.34) or for oyster shell recycling (G.S. 105-130.48) cannot be deducted as a contribution. The taxpayer is not required to add the contribution for which a credit is claimed to income under G.S. 105-130.2(a)(10).

P. Filing of Returns and Payment of Taxes

1. Time and Place for Filing

General business corporation franchise and income tax returns are due on the 15th day of the third month following the close of the income year and are filed on a combination return form. A short period return required as a result of a corporation becoming a member of a consolidated group for federal purposes may be filed on the due date of the federal short period return. However, interest is due beginning seventy-five (75) days following the last day of the short period.

Effective for taxable years beginning on or after January 1, 2006, a foreign corporation that files a federal income tax return pursuant to IRC §6072(c) is required to file its return on or before the 15th day of the sixth month following the close of its income year.

For purposes of determining the due date of tax returns and tax payments, an income year ending on any day other than the last day of the month shall be deemed to end on the last day of the calendar month ending nearest to the last day of a taxpayer's actual income year.

Example 1: The short tax period for Corporation X ends on May 14. The short period return and tax payment are due on July 15 (75 days after April 30.) On July 15, Corporation X may apply for an extension of time to file the short period return; however, to avoid penalty and interest, 100% of the tax due must be paid by July 15.

Example 2: The short tax period for Corporation Y ends on May 16. The short period return and tax payment are due on August 15 (75 days after May 31). On August 15, Corporation Y may apply for an extension of time to file the short period return;

however, to avoid penalty and interest, 100% of the tax due must be paid by August 15.

Returns of agricultural cooperatives are due on or before the 15th day of the ninth month following the close of the income year.

Tax-exempt organizations described in G.S. 105-130.11(a)(1) and (a)(3) through (a)(8) which are required to file a return under G.S. 105-130.11(b) shall file a calendar year return on or before May 15 of the following year and a fiscal year return on or before the 15th day of the fifth month following the close of the fiscal year.

Returns should be filed with the North Carolina Department of Revenue, P.O. Box 25000, Raleigh, North Carolina 27640-0500, or at one of the Department's local branch offices located in principal cities throughout the State.

7. Protective Refund Claim

A taxpayer can file a protective refund claim to protect his/her right to a potential refund of corporate income or franchise tax based on a contingent event for a taxable period for which the statute of limitations is about to expire. A protective claim is usually based on contingencies such as pending litigation or an ongoing tax audit in another state.

The Department of Revenue will accept a protective claim for refund if

- It is filed before the expiration of the statutory refund claim period;
- It identifies and describes the contingencies affecting the claim;
- It is sufficiently clear and definite to alert the Department of Revenue as to the essential nature of the claim; and
- It identifies the tax schedule and the specific year for which the protective claim is filed.

There is no special form for filing a protective claim. The Department of Revenue will accept any written submission *if* it meets all the required elements. Upon conclusion of the contingency, a taxpayer may finalize the claim for refund by filing an amended return for the tax year at issue.

It is not necessary for a taxpayer to file a protective refund claim for a year under examination by the Internal Revenue Service since, under North Carolina law, a taxpayer has two years after being notified of the federal changes to file an amended return to report the changes.

Effective for federal determinations made on or after July 1, 2006, a taxpayer whose federal taxable income is corrected or otherwise determined by the federal government has six months to report the federal corrections or determinations to the Department.

U. Reporting Federal Changes (G.S. 105-130.20, G.S. 105-241.1)

1. Requirement for Reporting Changes

If the amount of taxable income of any corporation subject to tax in this State, as reported or reportable to the United States Treasury Department, is changed by the U.S. Government, such corporation must file a return under oath reflecting such change within two years after receipt of the Federal report. Effective for federal corrections or determinations made on or after July 1, 2006, a corporation must report changes made by the federal government to the Department within six months after being notified by the federal government of the corrections or determinations.

W. S Corporations (G.S. 105-131)

2. Corporate Income of S Corporations Taxed to Shareholders (G.S. 105-131)

The S corporation's income and expenses are divided among and passed through to its shareholders, who then must report the income and expenses on their State individual return. Effective for taxable years beginning on or after January 1, 2006, the pro rata share of resident and nonresident shareholders in the income and expenses of an S Corporation is subject only to the adjustments under individual income tax law (G.S. 105-134.6), instead of the adjustments under both corporate income tax law (G.S. 105-130.5) and individual income tax law (G.S. 105-134.6).

X. Qualified Subchapter S Subsidiaries

3. Apportionment Factors

The parent S corporation must aggregate and include the subsidiary's items of income, loss, and deductions before determining the parent's apportionable or allocable income. The parent S corporation parent must also include the subsidiary's property, payroll and sales in calculating its ~~determining the parent's~~ apportionment factors. The parent S corporation must use the same apportionment factor that was used to apportion the combined income of the parent and subsidiaries to determine its capital stock, surplus and undivided profits franchise tax base. The QSSS does not calculate an apportionment factor for income tax since its income is taxed at the parent level. However, it must calculate its apportionment factor using its own property, payroll, and sales to determine its capital stock, surplus and undivided profits franchise tax base.

III. TAX CREDITS
(Articles 3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H and 4)

A. General Tax Credits

14. Credit for Qualifying Expenses of a Production Company (G.S. 105-130.47)

a. Credit

Effective for taxable years beginning on or after January 1, 2005, for qualifying expenses incurred on or after July 1, 2005, a taxpayer that is a production company and has qualifying expenses of at least two hundred fifty thousand dollars (\$250,000) with respect to a production is allowed a credit against corporate income taxes. The credit is equal to fifteen percent (15%) of the production company's qualifying expenses. The credit is claimed for the taxable year in which the production activities are completed but includes all of the taxpayer's qualifying expenses incurred with respect to the production, including qualifying expenses incurred in earlier years. In the case of an episodic television series, an entire season of episodes is one production.

b. Definitions

i. Qualifying Expenses

The sum of the amount spent in this State for the following by a production company in connection with a production, less the amount paid to a highly compensated individual:

- Goods and services leased or purchased ~~by the production company~~. For goods with a purchase price of twenty-five thousand dollars (\$25,000) or more, the amount included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.
- Compensation and wages ~~paid by the production company, other than amounts paid to a highly compensated individual~~, on which ~~the production company remitted~~ withholding payments are remitted to the Department of Revenue under Article 4A of this Chapter.

ii. Highly Compensated Individual

An individual who receives compensation in excess of one million dollars (\$1,000,000) with respect to a single production. If an individual receives compensation in excess of one million dollars (\$1,000,000), none of the compensation is included in the production's qualifying expenses. Effective for taxable years beginning on or after January 1, 2006, the definition of highly compensated individual is modified to mean an individual who receives compensation in excess of one million dollars (\$1,000,000) for personal services with respect to a single production, regardless of whether the individual receives the compensation directly from the production company or indirectly from a personal service company or an employee leasing company and regardless of whether the compensation is considered wages or nonemployee compensation.

iii. Production Company (G.S. 105-164.3)

A person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. However, radio productions do not qualify for the credit (see subsection 14.i below).

iv. Feature Film

A movie that is made for initial distribution in theaters and that is over forty (40) minutes long.

v. Live Sporting Event

A scheduled sporting competition, game, or race that is not originated by a production company, but is originated solely by an amateur, collegiate, or professional organization, institution, or association for live or tape-delayed television or satellite broadcast. A live sporting event ~~shall~~does not include commercial advertising, an episodic television series, a television pilot, a music video, a motion picture, or a documentary production where any sporting events are presented through archived historical footage or similar footage ~~depicting earlier live sporting events that originated more than (30) days before the time of such usage taken at least 30 days before it is used.~~

c. Qualifying Expenses for Compensation and Wages

Compensation and wages paid to employees for services performed in North Carolina on which income tax withholding payments are is—remitted to the Department of Revenue are eligible for the tax credit regardless of whether paid to residents or non-residents. Payments for per diem, living allowances, and fringe benefits are eligible to the extent they are included in the recipient’s taxable wages subject to federal income tax withholding. The amount paid to an individual through a personal services corporation or through an employee-leasing organization is considered compensation and is subject to the “highly compensated individual” limitations in calculating the allowable credit.

d. Qualifying Expenses for Services

Spending for services is eligible for the tax credit regardless of whether paid to residents or non-residents, as long as the services are performed in North Carolina. Effective for taxable years beginning on or after January 1, 2006, the amount paid to an individual through a personal services corporation or through an employee leasing organization is subject to the “highly compensated individual” limitation in calculating the allowable credit.

e. Qualifying Expenses for Goods

Spending for goods purchased or leased from a North Carolina business is eligible for the tax credit. This includes fuel, food, airline tickets and other goods if purchased or leased from a business located in North Carolina.

f. Pass-through Entity

Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for this credit does not allocate the credit among any of its owners. Instead, the pass-through entity is considered the taxpayer for purposes of claiming this credit. If a return filed by a pass-through entity indicates that the entity is paying tax on behalf of the owners of the entity, the credit allowed under this section does not affect the entity's payment of tax on behalf of its owners and cannot be applied against that liability.

g. Return

The credit is claimed on Form NC-415 filed for the taxable year in which the production activities are completed. Processing of the credit cannot begin until after the income tax return for the taxable year in which the production activities are completed is filed. The taxpayer must satisfy any tax liability for the tax year in which the tax credit is claimed before the credit will be refunded.

h. Credit Refundable

If the credit allowed exceeds the amount of income tax for the taxable year reduced by the sum of all credits allowable, the excess is refundable to the taxpayer. The refundable excess is governed by the same provisions that govern the refund of an income tax overpayment by the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits.

i. Limitations

The amount of credit allowed under this section with respect to a production that is a feature film may not exceed seven million five hundred thousand dollars (\$7,500,000). There is no maximum credit for other types of productions. No credit is allowed under this section for any production that satisfies one of the following conditions:

- It is political advertising.
- It is a television production of a news program or live sporting event.
- It contains material that is obscene, as defined in G.S. 14-190.1.
- It is a radio production.

j. Substantiation

A taxpayer allowed a credit under this section must maintain and make available for inspection any information or records required by the Secretary of Revenue. The taxpayer has the burden of proving eligibility for a credit and the amount of the credit. The Secretary may consult with the North Carolina Film Office of the Department of Commerce and the regional film commissions in order to determine the amount of qualifying expenses.

k. No Double Benefit

A taxpayer may not claim a credit under this section for qualifying expenses for

which it claimed a deduction under the Code. A taxpayer that claims a credit provided under this section must adjust taxable income as provided in G.S. 105-130.5(a)(18). For example, a taxpayer that has ten million dollars (\$10,000,000) in qualifying expenses is eligible for a tax credit of one million five hundred thousand dollars (\$1,500,000). Federal taxable income must be increased by ten million dollars (\$10,000,000) in determining income taxable in North Carolina. (Repealed for taxable years beginning on or after January 1, 2007.)

l. Sunset

This credit is repealed for qualifying expenses occurring on or after January 1, 2010.

15. Credit for Recycling Oyster Shells (G.S. 105-130.48)

Effective for taxable years beginning on or after January 1, 2006)

a. Credit

A taxpayer who donates oyster shells to the Division of Marine Fisheries of the Department of Environment and Natural Resources is eligible for a credit against corporate income tax. The credit is one dollar (\$1.00) per bushel of oyster shells donated.

b. Limitation

The credit allowed cannot exceed the amount of corporate income tax for the taxable year reduced by the sum of all credits allowable, except corporate income tax payments made by or on behalf of the taxpayer.

c. Carryforward

Any unused portion of this credit may be carried forward for the succeeding five years. A successor in business may take the carryforwards of a predecessor corporation as if they were carryforwards of a credit allowed to the successor in business.

d. No Double Benefit

A taxpayer that claims this credit may not take a deduction for a contribution allowed under G.S. 105-130.5(b)(5) or G.S. 105-130.9.

e. Substantiation

A taxpayer that claims this credit must obtain and maintain with its records, a certification by the Department of Environment and Natural Resources stating the number of bushels of oyster shells donated by the taxpayer.

f. Sunset

This credit is repealed for taxable years beginning on or after January 1, 2011.

B. Quality Jobs and Business Expansion Credits (Article 3A of Chapter 105)

1. General Information

a. Purpose

This section sets out guidelines for the tax credits in Article 3A of Chapter 105 of the General Statutes, also known as the William S. Lee Quality Jobs and Business Expansion Act. It applies to tax years beginning on or after January 1, 2006. Article 3A has been amended each year since its enactment. This section does not attempt to review the law in effect prior to January 1, 2006. It also does not address enhancements applying to major computer facilities. For a description of these enhancements, refer to G.S. 105-129.4(b7).

These guidelines are published by the Department and are updated periodically as issues arise that require clarification.

b. Overview

The Article 3A tax credits are designed to attract certain types of new businesses to North Carolina and to foster expansions of certain types of businesses in North Carolina. The credits are based on a system that divides the State into five enterprise tiers, with tier one being the most economically distressed and tier five being the least economically distressed. Eligibility requirements are easier to meet and credits are increased for business expansion occurring in the lower tiers. Each county is assigned a tier designation by the Secretary of Commerce on or before December 31st of each year. Generally, a designation applies only to the calendar year following the designation. A tier one or tier two area, however, may not be redesignated as a higher-numbered enterprise tier area until it has been in its designated enterprise tier area for at least two consecutive years. The Department of Commerce publishes a list of the counties and their respective tier designations.

Within each tier, there may be designated development zones or agrarian growth zones. These designations recognize defined areas of economic need within a tier. For purposes of the wage standard requirement, the credit for investing in machinery and equipment, and the credit for worker training, a development zone or an agrarian growth zone is considered an enterprise tier one area. Additionally, credits for creating jobs are increased by \$4,000 per job for jobs located within a development zone or an agrarian growth zone. Upon the request of a taxpayer or a local government, the Secretary of Commerce will determine whether an area is in a development zone or an agrarian growth zone. The determination is based on various economic factors. If an area is designated as a development zone, the designation is effective for 24 months following the date of the designation. If an area is designated as an agrarian growth zone, the designation is effective until December 31 of the year following the year in which the determination is made. The Department of Commerce publishes annually a list of all development zones and agrarian growth zones with a description of their boundaries.

A parcel of property that is partially in a development zone or an agrarian growth zone is considered to be entirely within the development zone or agrarian growth zone if all of the following conditions are met:

- At least fifty percent of the parcel is located within the development zone or agrarian growth zone.
- The parcel was in existence and under common ownership prior to the most recent federal decennial census.
- The parcel is a portion of land made up of one or more tracts or tax parcels of land that is surrounded by a continuous perimeter boundary.

c. Credits Available

Credits are available for:

- Creating jobs
- Investing in machinery and equipment
- Technology commercialization
- Worker training
- Investing in central office or aircraft facility property
- Development zone projects
- Substantial investment in other property

Note: The credit for research and development under Article 3A expired for activities occurring on or after January 1, 2006. It was replaced by the Article 3F credit for research and development credit. For information about the Article 3F credit, see G.S. 105-129.50.

d. Substantiation (G.S. 105-129.7)

To claim a credit, the taxpayer must provide any information considered necessary by the Secretary of Revenue to determine and verify the amount of the credit to which the taxpayer is entitled. The burden of proving eligibility for the credit and the amount of the credit rests upon the taxpayer. The taxpayer must submit a portion of the qualifying information with the tax return. That information is reported on the Department of Revenue NC-478 form series. The taxpayer must maintain additional documentation needed to substantiate the credit and make it available for inspection by the Secretary of Revenue.

2. General Eligibility Requirements (G.S. 105-129.4)

The taxpayer must satisfy all general eligibility requirements in order to qualify for any of the credits listed in Section III, except the credit for development zone projects. If a taxpayer is uncertain about its eligibility for a credit, the taxpayer may request specific advice in writing from the Secretary of Revenue.

The general eligibility requirements are listed below, followed by a description of each specific requirement:

- Be an eligible business type
- Meet the wage standard specified for the credit
- Provide health insurance for employees as specified for the credit
- Have a good environmental record

- Have a good Occupational Safety and Health Act (OSHA) record
- Have no overdue tax debts

a. Eligible Business Types

(1) Types

Article 3A allows tax credits only to certain types of businesses. Under the Article, the taxpayer must meet one of the following descriptions to be eligible for a credit. For definitions of the business types described below, see G.S. 105-129.2.

(a) Central Office or Aircraft Facility

The taxpayer operates a central office or aircraft facility that creates at least 40 new jobs and the jobs, investment, and activity with respect to which a credit is claimed are used in that office or facility. Generally, 40 new jobs are created if the taxpayer hires at least 40 additional full-time employees to fill new positions at the office within 12 months after the taxpayer first uses the property as a central office or aircraft facility. If a taxpayer uses temporary space, however, for the central office or aircraft facility functions during completion of the central office or aircraft facility property, the jobs must be created during the period starting 24 months before and ending 12 months after the completion of the property.

(b) Air Courier Services or Data Processing

The primary business of the taxpayer is one of the following and the jobs, investment, and activity with respect to which a credit is claimed are used in that business:

- Air courier services
- Data processing

(c) Manufacturing, Warehousing, or Wholesale Trade

The primary business of the taxpayer is one of the following and the jobs, investment, and activity with respect to which a credit is claimed are used in any of the listed businesses:

- Manufacturing
- Warehousing
- Wholesale trade

(d) Computer Services or Electronic Mail Order House

The primary business of the taxpayer or the primary activity of an establishment of the taxpayer is one of the following and the jobs, investment, and activity with respect to which a credit is claimed are used in that business:

- Computer services
- An electronic mail order house that creates at least 250 new jobs and is located in an enterprise tier one, tier two, or tier three area.

(e) Customer Service Center

The taxpayer operates a customer service center and meets all of the following conditions:

- The taxpayer's primary business is a telecommunications or financial services company as defined by NAICS.
- The primary activity of an establishment of the taxpayer is a customer service center located in an enterprise tier one, tier two, or tier three area.
- The jobs, investment, and activity with respect to which a credit is claimed are used in the operation of the customer service center.

(f) Warehousing at Establishment

The primary activity of an establishment of the taxpayer is warehousing and the taxpayer meets both of the following conditions:

- The warehousing establishment is located in an enterprise tier one, tier two, or tier three area and serves 25 or more establishments of the taxpayer in at least five different counties in one or more states.
- The jobs, investment, and activity with respect to which a credit is claimed are used in the warehousing establishment.

(g) Research and Development

For the purpose of determining eligibility under this subsection for the credit for research and development in G.S. 105-129.10, the following special rules apply:

- If the primary activity of an establishment of the taxpayer in this State is computer services, the taxpayer's qualified research expenditures in this State are considered to be used in computer services.
- For all other taxpayers, the taxpayer's qualified research expenditures in this State are considered to be used in the primary business of the taxpayer.

(2) Determining Primary Business

For most of the eligible business types, the law specifies that the taxpayer's primary business must be a designated business. To claim a credit as a taxpayer that provides air courier services or data processing services, for example, the provision of these services must be the primary business of the taxpayer and not just the taxpayer's primary activity at one establishment. Similarly, to claim a credit as a customer service center, the taxpayer's primary business must be telecommunications or financial services.

The determination of whether an activity of a company is its primary business is based on the principal product or group of products the taxpayer produces or distributes or the principal services the taxpayer provides. The principal product or service is determined based on the NAICS guidelines for determining industry classification. The activities at all the taxpayer's establishments are considered in determining the taxpayer's primary business.

(3) Determining Primary Activity at an Establishment

For a few of the eligible business types, the law only requires the taxpayer's primary activity at an establishment to be a designated business. The eligible business types for providing computer services, operating an electronic mail order house, and engaging in warehousing, for example, set requirements for the taxpayer's primary business activity at an establishment but not the taxpayer's primary business taken overall. The credit for a customer service center sets requirements for the taxpayer's primary business activity at an establishment and sets a different requirement for the taxpayer's primary business.

The determination of whether an activity at an establishment is the primary business activity is based on the proper classification of the establishment under the NAICS Code. If more than one activity is conducted at the same establishment, the primary activity of the establishment is determined based on the NAICS guidelines for determining industry classification.

(4) Determining What Jobs, Investment, and Activity Qualify for Credits

All the eligible business types require jobs, investment, and activity to be used in a specified aspect of the taxpayer's business. To satisfy this requirement, that aspect must be the primary activity of the taxpayer at the establishment where the credits are claimed.

For some eligible business types, the jobs, investment, and activity that qualify for the credit must be used in the taxpayer's primary business. For these eligible business types, the taxpayer's primary business must be one of the eligible business types and, if the taxpayer has more than one business establishment, the primary activity at the taxpayer's establishment where the credits are claimed must be the same as the taxpayer's primary business. When these conditions are met, the jobs, investment, and activity at the establishment are considered to be part of the taxpayer's primary business and to satisfy the requirement of being used in that business. The eligible business types for air courier services, data processing, manufacturing, warehousing, wholesale trade, computer services, and electronic mail order house fall into this category. The last five of these also fall into other categories due to alternative ways to qualify for the credits.

Some eligible business types have different requirements for primary business and primary business activity at an establishment. For these eligible business types, the taxpayer's primary business must be the specified type of business, the taxpayer must have more than one business establishment, the taxpayer's primary activity at the establishment where the credits are claimed must be the specified type of activity, and the taxpayer's primary business and the primary business activity at the establishment must be different. When these conditions are met, the jobs, investment, and activity at the establishment are considered to be part of the taxpayer's primary business activity at the establishment and to satisfy the requirement of being used in that specified business activity. The eligible business types for manufacturing, warehousing, wholesale trade, computer

services, electronic mail order house, and customer service center fall into this category. The first five of these also fall into other categories due to alternative ways to qualify for the credits.

Some eligible business types set no requirements on the taxpayer's primary business and, instead, set requirements only on the primary business activity at an establishment. For these credits, the primary business activity at the establishment where the credits are claimed must be the specified type of activity. This activity may also be the taxpayer's primary business, but it does not matter if the primary business activity at the establishment and the taxpayer's primary business are the same or are different. If they are different, however, the taxpayer must have more than one establishment. At the establishment, if the primary business activity is the specified type of activity, then the jobs, investment, and activity at the establishment are considered to be part of the primary business activity and to satisfy the requirement of being used in that primary business activity. The eligible business types for computer services, electronic mail order house, and warehousing at an establishment fall into this category. The eligible business types for computer services and electronic mail order house also fall into another category due to alternative ways to qualify for the credits.

Two eligible business types set requirements for a business function of the taxpayer rather than for primary business or primary business activity at an establishment. These two eligible business types are for a central office or an aircraft facility. For these eligible business types, the jobs, investment, and activity must be used in the central office function or the aircraft facility function. In most cases, the establishment where the central office or the aircraft facility is located will have a NAICS Code reflecting a central office or aircraft facility, but a central office or aircraft facility can be located in a building that includes various functions.

In summary, except for the eligible business types for a central office or an aircraft facility, the determination of whether jobs, investment, and activity qualify turns on the primary business activity at an establishment plus, for some eligible business types, the primary business of the taxpayer. When these conditions are met, all the jobs, investment, and activity at the establishment are considered to be used in the qualifying business, even though they may be part of a support function at the establishment.

The following examples illustrate when jobs, investment, and activity satisfy the requirement of being used in a business:

> ABC Manufacturing Company

ABC's primary business is manufacturing. In the 2006 tax year, ABC constructs and begins operating a North Carolina manufacturing facility. The new jobs, investment, and activity at the North Carolina manufacturing facility are eligible for credits, subject to the other

requirements of Article 3A. This is because ABC's primary business of manufacturing is an eligible business type and its primary business activity at the North Carolina facility is the same as its primary business. The jobs, investment, and activity at the North Carolina establishment therefore satisfy the requirement of being used in the manufacturing business.

> EFG Manufacturing Company

EFG's primary business is manufacturing. All of EFG's manufacturing plants are located outside North Carolina. In the 2006 tax year, EFG constructs and begins operating a North Carolina warehouse facility. The new jobs, investment, and activity at the North Carolina warehouse facility are eligible for credits, subject to the other requirements of the Act. This is because EFG's primary business is manufacturing, and the jobs, investment, and activity are used in the warehousing business.

> XYZ Manufacturing Company

XYZ's primary business is manufacturing. XYZ has one manufacturing plant located in the State. XYZ has previously qualified for credits for new jobs, investment, and activity used in the manufacturing business. During the 2006 tax year, XYZ purchases a facility in North Carolina that conducts marketing, customer service, and product repairs. Additionally, a retail outlet is on site at the newly purchased facility. The new jobs investment, and activity at the newly purchased facility are not eligible for credits. This is because the primary business activity at the facility is not manufacturing, wholesale trade, or warehousing.

b. Wage Standard (G.S. 105-129.4(b))

(1) Wage Standard Test

The taxpayer must satisfy a wage standard test with respect to each potential credit except the worker training credit and the credit for substantial investment in other property. The test is performed by comparing the applicable wage standard for the taxpayer to the wage standard for the relevant county. The county wage standard is obtained from the Department of Commerce. If the taxpayer's tax year is other than a calendar year, the taxpayer must use the wage standard for the calendar year in which the taxpayer's tax year begins. The taxpayer's wage standard must equal or exceed 110% of the county wage standard. The wage standard test does not apply to any credit in a tier one or tier two area or in a development zone or an agrarian growth zone. The wage standard test that applies depends on the credit, as explained below.

(a) Credit for Creating Jobs

The test is a two-part test. The first part requires the combined average weekly wage of the jobs for which the credit is claimed to meet the wage standard. The second part requires the combined average weekly wage of all jobs at the

location with respect to which a credit is claimed to meet the wage standard. The average wage for both parts of the test is determined for the tax year in which the activity that qualifies for the credit occurs, even if the taxpayer's tax year is not a calendar year. For part-time employees, a full-time equivalency factor must be used. However, all part-time jobs for which the taxpayer provides health insurance, as described in G.S. 105-129.4(b2), are considered to meet the wage standard, regardless of the actual wages for the job. If there are potential credits at more than one location, both tests must be applied separately at each location. No credits are allowed with respect to jobs at a location unless both tests are met.

The term "location" means a specific establishment with one exception. The exception is for purposes of the wage standard for a fiber, yarn, or thread mill that uses a sequential manufacturing process in which separate parts of the sequential manufacturing process are performed in different facilities within the same county. Under those parameters, a location may mean either the specific establishment or all facilities in the county in which parts of the process are performed.

The following example demonstrates the calculation of the wage standard test when new jobs are created during the year at multiple locations. Assume that the taxpayer meets all the other eligibility requirements in Article 3A.

Taxpayer creates 75 new jobs at a tier four location during the year and 50 new jobs at a tier five location. The combined average weekly wage of the 75 jobs created at the tier four location meets the wage standard and the combined average weekly wage of the 50 jobs created at the tier five location meets the wage standard. The jobs at both locations therefore meet the first part of the test.

The combined average weekly wage of all the jobs at the tier four location meets the wage standard. However, the combined average weekly wage of all the jobs at the tier five location does not meet the wage standard. Consequently, the taxpayer is eligible to claim a credit for the 75 jobs created at the tier four location, but not the 50 jobs created at the tier five location. This is because the jobs at the tier four location meet the second part of the test and the jobs at the tier five location do not.

(b) Credit for Worker Training

The credit for worker training is not subject to a wage standard test.

(c) Credit for Substantial Investment in Other Property

The credit for substantial investment in other property is not subject to a wage standard test.

(d) All Other Credits

Only the second part of the wage standard test for the jobs credit and the worker training credit apply to the other credits. The other credits are the credit for investing in machinery and equipment, the credit for research and development and the credit for investing in real property for a central office or an aircraft facility. The taxpayer is eligible for these credits if the combined average weekly wage of all jobs at the location with respect to which the credit is claimed meets the wage standard. The average wages of the jobs at the location are determined for the tax year in which the activity that qualifies for the credit occurs, even if the taxpayer's tax year is not a calendar year. For part-time employees, a full-time equivalency factor must be used.

(2) Wage Standard Calculations

- (a) One of the wage tests is to determine if the average wage of all jobs at a business location meets the wage standard. To make that determination, complete the following steps:
- (i) For each month in the tax year, identify the number of employees for the location who were included on line 1 of the Employer's Quarterly Tax and Wage Report (NCUI 101) as filed with the Employment Security Commission.
 - (ii) Add the number of employees identified in (a)(i) above for each month and divide that amount by 12.
 - (iii) Divide the total wages included on line 2 of Form NCUI 101 for each month for this location for the tax year by the number calculated in (a)(ii) above.
 - (iv) Divide the amount calculated in (a)(iii) above by 52.
 - (v) Compare the amount calculated in (a)(iv) above to the applicable wage standard for the county where the jobs were located.
- (b) The other wage test is to determine if the average wage of jobs for which a potential credit may be claimed meets the wage standard. To make that determination, complete the following steps:
- (i) For each employee, divide the number of hours worked, not including overtime, by 2080. Hours worked included all regular hours for which the employee received pay including vacation and sick time.
 - (ii) Divide each employee's total wages for the tax year by the amount calculated in (b)(i) above.
 - (iii) Divide each amount calculated in (b)(ii) above by 52.
 - (iv) Sum the amounts calculated in (b)(iii) for each employee and divide by the number of employees.
 - (v) Compare the amount calculated in (b)(iv) above to the applicable wage standard for the county where the jobs were located.

The above calculations are to be used if the taxpayer is in business at the location with respect to which credits are claimed for its entire tax year. If the taxpayer is in business at the location for only a portion of the year, the calculations must be adjusted accordingly. For example, Company X is an existing North Carolina taxpayer that files on a calendar year basis. On April 1, 2006, it expands its operations by opening a new manufacturing plant in North Carolina. Subsection 3 below shows how Company X would determine if the average wage of all jobs at the new location meets the wage standard. Subsection 4 below shows how Company X would determine if the average wage of jobs at the new location for which a potential credit may be claimed meets the wage standard.

- (c) To determine if jobs at the Company X New Location meet the wage standard in the 2006 tax year, complete the following steps:
 - (i) For the months April through December, identify the number of employees for the location who were included on Line 1 of the Employer's Quarterly Tax and Wage Report (NCUI 101) as filed with the Employment Security Commission.
 - (ii) Add the number of employees identified in (c)(i) for each month and divide that amount by 9.
 - (iii) Divide the total wages included on Line 2 of form NCUI 101 for this location for April through December by the number calculated in (c)(ii).
 - (iv) Divide the amount calculated in (c)(iii) by 39.
 - (v) Compare the amount calculated in (c)(iv) to the applicable wage standard for the county where the jobs are located.

- (d) To determine if jobs at the Company X New Location for which a potential credit may be claimed meet the wage standard in the 2006 tax year, complete the following steps:
 - (i) For each employee, divide the number of hours worked, not including overtime, by 1,560 (2,080 times .75). Hours worked includes all regular hours for which the employee received pay including vacation and sick time.
 - (ii) Divide each employee's total wages for the months April through December by the amount calculated in (d)(i).
 - (iii) Divide each amount calculated in (d)(ii) by 39.
 - (iv) Sum the amounts calculated in (d)(iii) for each employee and divide by the number of employees.
 - (v) Compare the amount calculated in (d)(iv) to the applicable wage standard for the count where the jobs are located.

c. Health Insurance (G.S. 105-129.4(b2))

Article 3A makes the provision of health insurance a condition for qualifying for the credits. The reason for this is to ensure that the credits are allowed only for quality jobs.

A taxpayer provides health insurance if it pays at least 50% of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125. The specific health insurance requirements for each credit are described below.

(1) Credit for Creating Jobs and Credit for Worker Training

A taxpayer is eligible for a credit for creating jobs or for worker training if the taxpayer provides health insurance for the jobs for which a credit is claimed. The insurance must be provided at the time the jobs are created or the workers are trained and must be maintained in each year the taxpayer claims an installment or a carryforward of the credit. To ensure that a taxpayer satisfies this requirement, the taxpayer must provide with the tax return a certification that the taxpayer provides health insurance for the affected jobs. This applies to the return on which the taxpayer qualifies for the credit, a return claiming an installment of the credit, and a return claiming a carryforward of the credit.

(2) All Other Credits

The health insurance requirement for the jobs credit and the worker training credit differs from the requirement for all the other credits. The other credits are the credit for investing in machinery and equipment, the credit for research and development, the credit for investing in real property for a central office or an aircraft facility, and the credit for substantial investment in other property. The taxpayer is eligible for these credits if the taxpayer provides health insurance for all of the full-time positions at the location with respect to which a credit is claimed. The insurance must be provided at the time of the activity that qualifies for the credit and must be maintained. The taxpayer must provide with the tax return a certification that the taxpayer provides health insurance for all the full-time positions at the location. This applies to the return on which a taxpayer qualifies for the credit and a return claiming an installment or carryforward of the credit.

d. Environmental Impact (G.S. 105-129.4(b3))

Article 3A requires recipients of credits to have good environmental records. The environmental requirements are the same for all credits. A taxpayer is eligible for a credit only if the taxpayer certifies that, at the time the taxpayer first claims the credit, the taxpayer has no pending administrative, civil, or criminal enforcement action based on alleged significant violations of any program implemented by an agency of the Department of Environment and Natural Resources, and has had no final determination of responsibility for any significant administrative, civil, or criminal violation of any program implemented by an agency of the Department of

Environment and Natural Resources within the last five years. A significant violation is a violation or an alleged violation that does not satisfy any of the conditions of G.S. 143-215.6B(d).

The Department of Revenue receives notification from the Department of Environment and Natural Resources annually of every person that currently has any of these pending actions and every person that has had any of these final determinations within the last five years. The Department of Revenue uses this information when reviewing eligibility for the credits.

The time the taxpayer first claims a credit is the date the taxpayer first files a tax return concerning the credit. The first tax return concerning the credit is the tax return for the year in which the taxpayer engaged in the qualifying activity.

e. Occupational Safety and Health Programs (OSHA) (G.S. 105-129.4(b4))

Article 3A requires recipients of credits to have good occupational safety and health (OSHA) records. The OSHA requirements are the same for all credits. A taxpayer is eligible for a credit only if the taxpayer certifies that, at the business location with respect to which the credit is claimed, the taxpayer has had no citations under the Occupational Safety and Health Act that have become a final order within the past three years for willful serious violations or for failing to abate serious violations. The certification must be made at the time the taxpayer first claims the credit. A "serious violation" is defined in G.S. 95-127.

The Department of Revenue receives notification from the Department of Labor annually of all employers with citations that have become final orders within the past three years. The Department of Revenue uses this information when reviewing eligibility for the credits.

The time the taxpayer first claims a credit is the date the taxpayer first files a tax return concerning the credit. The first tax return concerning the credit is the tax return for the year in which the taxpayer engaged in the qualifying activity.

f. Large Investment Enhancements (G.S. 105-129.4(b1))

A taxpayer who is otherwise eligible for a tax credit under this Article becomes eligible for the large investment enhancements provided for credits under this Article if the Secretary of Commerce makes a written determination that the taxpayer is expected to purchase or lease, and place in service in connection with the eligible business within a two-year period, at least one hundred fifty million dollars (\$150,000,000) worth of one or more of the following: real property, machinery and equipment, or central office or aircraft facility property. In the case of an interstate air courier that has or is constructing a hub in this State and in the case of an eligible major industry, this investment may be placed in service in connection with the eligible business within a seven-year period. To be an eligible major industry, the taxpayer must be primarily engaged in one of the industries defined in G.S. 105-164.14(j)(3), and be certified by the Secretary of Commerce as

planning to invest at least one hundred million dollars (\$100,000,000) of private funds to construct a facility in this State to engage in one or more of those industries.

g. No Overdue Tax

A taxpayer is ineligible for an Article 3A tax credit if the taxpayer has an overdue tax debt at the time the taxpayer claims a credit or an installment or carryforward of a credit. An overdue tax debt is defined in G.S. 105-243.1(a)(1) as “[a]ny part of a tax debit that remains unpaid 90 days or more after the notice of final assessment was mailed to the taxpayer. The term does not include a tax debt, however, if the taxpayer entered into an installment agreement for the tax debt under G.S. 105-237 within 90 days after the notice of final assessment was mailed and has not failed to make any payments due under the installment agreement.”

3. General Administration

a. Sunset (G.S. 105-129.2A(a), (a1), and (a2))

Article 3A is repealed for business activities that occur on or after January 1, 2007, with these exceptions:

- In the case of a taxpayer that qualifies as an eligible major industry on or before January 1, 2008, this Article is repealed effective for business activities that occur on or after January 1, 2010.
- This Article is repealed effective for business activities that occur on or after January 1, 2008 if a taxpayer signs a letter of commitment with the Department of Commerce on or before December 31, 2006 stating that the taxpayer’s intent to create new jobs or make new investments with respect to machinery and equipment, central office or aircraft facility property, or substantial investment in other real property at a specific site in this State in 2007. If the taxpayer has a letter of commitment and conducts an activity that qualifies for one of the Article 3A credits, the taxpayer may not take any Article 3J credits with respect to an establishment if the taxpayer claims Article 3A credits for activities at that establishment in 2007.

b. Expiration (G.S. 105-129.4(a2) and (b2))

This section addresses general expiration provisions applying to all credits based on failure to continue to meet general eligibility requirements. In addition, there are expiration provisions that apply specifically to each credit. The specific provisions are discussed in the sections devoted to each credit. The general expiration provisions are listed below. When a credit expires, the taxpayer may not take any remaining installments of the credit.

The expiration of a credit may also affect the taxpayer's ability to take carryforwards of a credit. Under the first two circumstances described below, the taxpayer may continue to claim carryforwards of previous installments when a credit expires. Under the third circumstance, the carryforwards as well as the

installments expire. See the section on Carryforwards of Unused Credits for additional information.

The following are circumstances that result in expiration of a credit:

- During the period that installments of a credit accrue, the taxpayer no longer meets one of the conditions for an eligible business type.
- During the period that installments of a credit accrue, the number of jobs of an eligible business falls below the minimum number required. When this happens, any credit associated with that business expires; the expiration is not limited to the jobs tax credit.
- The taxpayer ceases to provide health insurance for its employees.

c. Forfeiture (G.S. 105-129.4(d))

A taxpayer that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest at the rate established under G.S. 105-241.1(i), computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due 30 days after the date the credit is forfeited. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the penalties provided in G.S. 105-236. Forfeiture provisions are listed below.

(1) All Credits

A taxpayer forfeits a credit allowed if the taxpayer was not eligible for the credit for the calendar year in which the taxpayer engaged in the activity for which the credit was claimed.

(2) Worker Training

If a taxpayer forfeits the credit for creating jobs, the technology commercialization credit, or the credit for investing in machinery and equipment, it also forfeits any credit for worker training claimed for the jobs for which the credit for creating jobs was claimed or the jobs at the location with respect to which the technology commercialization credit or the credit for investing in machinery and equipment was claimed.

(3) Substantial Investment in Other Property

A taxpayer forfeits the credit for substantial investment in other property if it fails to timely make the required level of investment or fails to timely create the required number of new jobs.

(4) Technology Commercialization Credit

A taxpayer forfeits the technology commercialization credit if it fails to timely make the required level of investment or if it fails to meet the terms of its licensing agreement with a research university. If a taxpayer claimed a 20% technology commercialization credit and fails to make the required level of investment for the 20% credit, but does make the required level of investment for the 15% credit, the taxpayer forfeits one-fourth of the 20% credit.

(5) Large Investment Enhancements

A taxpayer forfeits a large investment enhancement of a tax credit if it fails to timely make the required level of investment.

(6) Eligible Major Industry Enhancements

A taxpayer forfeits the eligible major industry enhancements, including a delayed sunset of the Article 3A credits and an extended time to make sufficient investments to qualify for the large investment enhancements, if the taxpayer fails to timely make the required level of investment.

d. Change in Ownership of Business (G.S. 105-129.4(e))

The sale, merger, consolidation, conversion, acquisition, or bankruptcy of a business, or any transaction by which an existing business reformulates itself as another business does not create new eligibility in a succeeding business with respect to credits for which the predecessor was not eligible. A successor business may, however, take any installment of or carried-over portion of a credit that its predecessor could have taken if it had a tax liability. The acquisition of a business is a new investment that creates new eligibility in the acquiring taxpayer under Article 3A if any of the following conditions are met:

- The business closed before it was acquired.
- The business was required to file a notice of plant closing or mass layoff under the federal Worker Adjustment and Retraining Notification Act, 29 U.S.C. §2102, before it was acquired.
- The business was acquired by its employees through an employee stock option transaction or another similar transaction.

The term "business" means a taxpayer or an establishment. For example, a taxpayer that purchases one of five plants from an unrelated entity has acquired a business, and must meet one of the three conditions described above in order to create new eligibility for its investment.

e. Tax Election (G.S. 105-129.5)

The credits are allowed against the franchise tax, the income tax, or the gross premiums tax. The taxpayer elects 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 on all future installments and carryforwards of that credit. A special election is provided for the technology commercialization credit. A general election applies to all other credits.

(1) Technology Commercialization Credit

The technology commercialization credit may be divided between the taxes against which it is allowed. The taxpayer elects the percentage of the credit that will be taken against each tax when filing the return on which the credit is first

taken. This election is binding. The percentage of the credit elected to be taken against each tax may be carried forward only against the same tax.

(2) All Other Credits

The taxpayer must take a credit against only one of the taxes against which it is allowed.

f. Fifty Percent (50%) Cap on Credits (G.S. 105-129.5(b))

The total of all credits may not exceed 50% of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits allowed against that tax, except tax payments made by or on behalf of the taxpayer.

g. Carryforward of Unused Credit (G.S. 105-129.5(c))

Generally, any unused portion of a credit may be carried forward for the succeeding five years. Several credits have longer carryforward periods, however. Those credits and their carryforward periods are listed below.

(1) 20-Year Carryforward

Any unused portion of the following credits may be carried forward for 20 years:

- Technology commercialization.
- Substantial investment in other property.
- Credits concerning a "large investment" (\$150,000,000). A taxpayer is eligible for the large investment enhancement if the Secretary of Commerce makes a written determination that the taxpayer is expected to purchase or lease, and place in service in connection with the eligible business within a two-year period (seven years for interstate air couriers and eligible major industries), at least \$150,000,000 worth of one or more of the following: real property, machinery and equipment, or central office or aircraft facility property. If the taxpayer fails to make the required level of investment within the two-year period (seven years for interstate air couriers and eligible major industries), the taxpayer forfeits the longer carryforward period.

(2) 15-Year Carryforward for Research and Development

Any unused portion of a research and development credit may be carried forward for the succeeding 15 years.

(3) 10-Year Carryforward for \$50,000,000 Investment

Any unused portion of a credit may be carried forward for the succeeding 10 years if the taxpayer is expected to purchase or lease, and place in service in connection with the eligible business within a two-year period (seven years for interstate air couriers and eligible major industries), at least \$50,000,000 worth of one or more of the following: real property, machinery and equipment, or central office or aircraft facility property. The Secretary of Commerce must issue a written determination that the required investment is expected to be made in order

for this extended carryforward period to apply. If the taxpayer fails to make the required level of investment within the two-year period (seven years for interstate air couriers and eligible major industries), the taxpayer forfeits the longer carryforward period.

h. Advisory Ruling (G.S. 105-129.4(g))

A taxpayer may request in writing from the Secretary of Revenue specific advice regarding eligibility for a credit. G.S. 105-264 governs the effect of this advice.

i. Statute of Limitations (G.S. 105-129.5(d))

A taxpayer must claim a credit within six months after the date set by statute for the filing of the return that coincides with the year that the taxpayer qualified for the credit, including any extensions of that date. The following example illustrates this requirement:

A calendar year taxpayer creates 10 new qualifying jobs in 2006. The taxpayer files a timely extension on March 15, 2007, which extends the due date of the tax return to October 15, 2007. Applying the six-month statute of limitations, the taxpayer has until April 15, 2008 to file the NC-478A and report the 2006 credit for creating jobs. If the taxpayer had not filed a timely extension by March 15, 2007, the NC-478A would have had to be filed by September 15, 2007.

j. Fees (G.S. 105-129.6)

A fee of \$500.00 is required for each credit the taxpayer intends to claim with respect to a location that is in an enterprise tier three, four, or five area, subject to a maximum fee of \$1,500.00. There is no fee for a credit in an enterprise tier one or tier two area. There is also no fee for a credit with respect to a location that is in a development zone or an agrarian growth zone. If the taxpayer intends to claim a credit that relates to locations in more than one enterprise tier area, the fee is based on the highest-numbered enterprise tier area. The fee is due at the same time as the tax return and the credit will not be allowed until the fee is paid.

k. Forms

The Form NC-478 series is used to calculate and report tax credits, including the Article 3A tax credits that are limited to 50% of the taxpayer's tax less the sum of all other credits that the taxpayer claims. Forms NC-478A through NC-478I are used to calculate the specific credits without regard to the 50% limitation. Form NC-478 is used to total the specific credits, to determine if the 50% limitation applies, and, if so, to allocate the limited total credit among the specific credits. Form NC-478V is used to report the fee that is due.

The table below lists the tax credits that are subject to the 50%-of-tax limitation and the NC-478 series form on which the credit is reported. The table also indicates if the credit is an Article 3A credit.

Credit	File Form NC-478 plus Form:	Article 3A?
Creating Jobs	NC-478A	Yes
Investing in Machinery and Equipment	NC-478B	Yes
Research and Development (SEE NOTE BELOW)	NC-478C	Yes
Worker Training	NC-478D	Yes
Investing in Central Office or Aircraft Facility Property	NC-478E	Yes
Investing in Business Property (SEE NOTE BELOW)	NC-478F	No; in Art. 3B
Investing in Renewable Energy Property	NC-478G	No; in Art. 3B
Low-income Housing	NC-478H	No; in Art. 3E
Research and Development	NC-478I	No; in Art. 3F
Contributions to Development Zone Projects	No additional form. Use NC-478, line 12	Yes
Technology Commercialization	No additional form. Use NC-478, line 9	Yes
Investing in Non-hazardous Dry-cleaning Equipment	No additional form. Use NC-478, line 10	No; in Art. 3B
Use of North Carolina Ports	Attach Form NC-414 Use NC-478, line 12	No; in Art. 4
Renewable Energy Equipment Facility	No additional form. Use NC-478, line 12	No; in Art. 4
Manufacturing Cigarettes for Export	No additional form. Use NC-478, line 12	No; in Art. 4
Manufacturing Cigarettes for Export While Increasing Employment	No additional form. Use NC-478, line 12	No; in Art. 4
Substantial Investment in Other Property	No additional form. Use NC-478, line 12	Yes
Renewable Fuel Facility	No additional form. Use NC-478, line 11	No; in Art. 3B

Note: The Article 3A Research and Development credit expired for activities occurring on or after January 1, 2006. The Investing in Business Property credit expired for investments made after December 31, 2001. Remaining carryforwards of unused installments of these credits may still be taken on Form NC-478, Line 3a and Line 7, respectively.

Both Form NC-478 and any applicable Form NC-478 series form must be filed for any taxable year in which the taxpayer is eligible to claim a credit or 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. If the taxpayer engages in activities that qualify for the credit for creating jobs, the credit for investing in machinery and equipment, or the credit for investing in central office or aircraft facility property, the taxpayer must complete Part 1 of Form NC-478A, Form NC-478B, or Form NC-478E and file the form with the taxpayer's return for the taxable year in which the taxpayer engages in the activity, even though the first installment of the credit will not be claimed until the following year.

For further information about the Form NC-478 series, see Form NC-478 INST, *Instructions for 2006 Form NC-478 Series*.

1. Overdue Tax Debts (G.S. 105-129.4(b6))

A taxpayer is ineligible for an Article 3A tax credit if the taxpayer has an overdue tax debt at the time the taxpayer claims an installment or carryforward of a credit. An overdue tax debt is defined in G.S. 105-243.1(a)(1) as “[a]ny part of a tax debit that remains unpaid 90 days or more after the notice of final assessment was mailed to the taxpayer. The term does not include a tax debt, however, if the taxpayer entered into an installment agreement for the tax debt under G.S. 105-237 within 90 days after the notice of final assessment was mailed and has not failed to make any payments due under the installment agreement.”

4. Credit for Creating Jobs (G.S. 105-129.8)

a. Eligibility

To be eligible for a credit for creating jobs, a taxpayer must meet the following conditions:

- Meet all general eligibility requirements described in Section 2.
- Have five or more full-time employees.
- Hire an additional full-time employee during the year to fill a position located in this State.

b. Terms Used

(1) Creating a New Full-time Job

To determine the number of new jobs filled, the taxpayer subtracts the highest number of full-time employees the taxpayer had in the State at any time during the twelve-month period preceding the beginning of the taxable year from the number of full-time employees the taxpayer has in the State at the end of the taxable year.

(2) Full-time Job

A position that requires at least 1,600 hours of work per year and is intended to be held by one employee during the entire year.

(3) Location of a Job

A job is located in an area if more than fifty percent of the employee's duties are performed in the area.

c. Credit Amount

The amount of credit allowed is based upon the enterprise tier of the area in which the position is located as shown below:

Area Enterprise Tier	Amount of Credit for Each Job
Tier One	\$12, 500
Tier Two	4,000
Tier Three	3,000
Tier Four	1,000
Tier Five	500
Agrarian Growth Zone or Development Zone in Any Tier	\$4,000 plus the amount for the Tier

d. Taking the Credit

The credit is taken in four equal installments over the four-year period beginning the year after the taxpayer qualifies for the credit. If a taxpayer is required to file more than one tax return during a year, each return constitutes a year for purposes of taking installments of the credit.

e. Expiration

If, in one of the four years in which an installment accrues, the number of the taxpayer's full-time employees in the State falls below the number of full-time employees the taxpayer had in the State in the year in which the taxpayer qualified for the credit, the credit expires and the taxpayer may not take any remaining installments of the credit. This calculation is illustrated by the following example:

Taxpayer is claiming a credit for forty jobs in tier four at \$1,000 per job. The installments are \$10,000 each over four years. During the year that the third installment of the credit accrues, the taxpayer loses twelve jobs. The third and fourth installments must be recalculated to recognize the loss of the jobs. After the recalculation, the third and fourth installments that remain to be taken are \$7,000 each, rather than \$10,000 each, computed as follows:

$$\frac{(40 - 12) \times \$1,000}{4}$$

If the taxpayer has carryforwards from the first and second installments attributable to the 12 lost jobs, the taxpayer can continue to take the carryforwards for these even though the installments have expired. When a credit expires, the taxpayer can still take the portion of an installment that accrued in a previous year and was carried forward.

f. Movement of Jobs

Jobs transferred from one area in the State to another area are not considered new jobs. If a job qualifies for the credit in one tier, but is moved to another enterprise tier, the credit is recomputed as if the job had been created initially in the area to which it was moved.

g. Planned Expansion

A taxpayer that signs a letter of commitment with the Department of Commerce to create at least 20 new full-time jobs in a specific area within two years (seven years for interstate air couriers and eligible major industries) of the date the letter is signed qualifies for the credit in the amount allowed based on the area's enterprise tier and development zone or agrarian growth zone designation for that year even though the employees are not hired that year. The credit is available in the taxable year after at least 20 employees have been hired if the hirings are within the two-year (seven years for interstate air couriers and eligible major industries) commitment period. If the taxpayer does not hire the employees within the two-year (seven years for interstate air couriers and eligible major industries) period, the taxpayer does not get the benefit of the letter of commitment.

5. Credit for Investing in Machinery and Equipment (G.S. 105-129.9)

a. Eligibility

To be eligible for a credit for investing in machinery and equipment, a taxpayer must:

- Meet all general eligibility requirements described in “General Eligibility Requirements.”
- Purchase or lease eligible machinery and equipment.
- Place the eligible machinery and equipment in service during the taxable year.

b. Terms Used

(1) Cost

In the case of property owned by the taxpayer, cost is determined pursuant to regulations adopted under section 1012 of the Internal Revenue Code. In the case of property the taxpayer leases from another, cost is valued at eight times the net annual rental rate as described in G.S. 105-130.4(j)(2).

(2) Eligible Machinery and Equipment (G.S. 105-129.10)

Machinery and equipment are eligible if they are capitalized by the taxpayer for tax purposes under the Internal Revenue Code and are not leased to another party. Property expensed under Section 179 of the Code is not eligible. In the case of a qualifying large investment, machinery and equipment that are not capitalized by the taxpayer are eligible if the taxpayer leases them from another party.

(3) Machinery and Equipment

Engines, machinery, equipment, tools, and implements used or designed to be used in the business for which the credit is claimed. The term does not include

real property as defined in G.S. 105-273 or rolling stock as defined in G.S. 105-333.

c. Credit Amount

The credit is 7% of the excess of the eligible investment amount over the applicable threshold if the investment is placed in service in a tier one or tier two area, 6% for tier three, 5% for tier four, and 4% for tier five. Business activities subject to a letter of commitment applied for before January 1, 2003 qualify for a 7% credit regardless of the tier in which the investment is placed in service.

The eligible investment amount is the lesser of the following:

- The cost of the machinery and equipment.
- The amount by which the cost of all of the taxpayer's machinery and equipment that is in service in North Carolina on the last day of the taxable year exceeds the cost of all of the taxpayer's machinery and equipment that was in service in North Carolina on the last day of the base year. The base year is that year, of the three immediately preceding taxable years, in which the taxpayer had the most machinery and equipment in service in North Carolina.

The threshold is based on the enterprise tier of the area where the machinery and equipment are placed in service during the taxable year. Thresholds for tier one through tier five are as follows:

Enterprise Tier Area	Threshold
Tier One	\$ -0-
Tier Two	100,000
Tier Three	200,000
Tier Four	1,000,000
Tier Five	2,000,000

Note: For purposes of the wage standard requirement, the credit for investing in machinery and equipment, and the credit for worker training, a development zone or agrarian growth zone is considered an enterprise tier one area.

If the taxpayer places eligible machinery and equipment in service in an area over the course of a two-year period, the applicable threshold for the second taxable year is reduced by the eligible investment amount for the previous taxable year.

If machinery and equipment are placed in service at two or more establishments within the same tier during the taxable year, the threshold must be applied to each establishment.

d. Taking the Credit

The credit is taken in seven equal installments beginning the year after the taxpayer qualifies for the credit. If a taxpayer is required to file more than one tax return during a year, each return constitutes a year for purposes of taking installments of the credit.

e. Expiration

Generally, if machinery and equipment are disposed of, taken out of service, or moved out of North Carolina prior to the end of the seven-year period in which the credit is claimed, the amount of credit that relates to the machinery and equipment no longer in service expires and a taxpayer may not take any remaining installment related to this machinery and equipment. However, a taxpayer that replaces or otherwise disposes of machinery and equipment for which a credit was claimed can continue to take the remaining installments of the credit that relate to the machinery and equipment no longer in service if the net reduction in the cost of the taxpayer's eligible machinery and equipment in the enterprise tier does not exceed 20% of the cost of the disposed property. If the net reduction exceeds 20%, the remaining installments of the credit expire. If during a single tax year the taxpayer disposes of machinery and equipment with respect to two or more credits in the same tier, costs are calculated based on all credits affected.

The "net investment reduction" calculation is illustrated by the following example:

- Taxpayer has \$10,000,000 of eligible machinery and equipment in service in tier one.
- During the tax year, a piece of equipment with a cost of \$2,500,000 is taken out of service.
- There are remaining installments of a credit related to the equipment taken out of service.
- Replacement equipment is placed into service during the same tax year at a cost of \$1,500,000.
- Total cost of eligible equipment at the end of the tax year is \$9,000,000.

The net investment reduction in tier one is \$1,000,000 (\$10 million - \$9 million). Twenty percent of the cost of the equipment taken out of service is \$500,000 ($\$2,500,000 \times .20$). The net reduction in total eligible equipment (\$1 million) is greater than 20% of the cost of the equipment taken out of service (\$500,000). Therefore, the installments related to the \$2,500,000 piece of equipment expire.

If a taxpayer disposes of a portion of the machinery and equipment for which a credit is claimed, and the taxpayer is not entitled to continue taking the installments of the credit in accordance with the "net investment reduction" calculation illustrated above, the amount of the credit associated with the machinery and equipment no longer in service expires. This calculation is illustrated by the following example:

- Taxpayer has \$10,000,000 of eligible machinery and equipment in service in tier one where the threshold is \$0.
- Taxpayer is claiming a credit of \$700,000 at \$100,000 per installment based on its \$10,000,000 investment.
- During the year that the third installment of the credit accrues, a piece of equipment for which the credit is claimed with a cost of \$2,500,000 is taken out of service.

The remaining installments beginning in year three are \$75,000 each, computed as follows:

$$\frac{\$10,000,000 - \$2,500,000 \times .07}{7}$$

When a credit expires, a taxpayer can still take a portion of an installment that is related to the machinery and equipment no longer in service and accrued in a previous year and was carried forward.

f. Movement to Higher Tier (G.S. 105-129.9(d))

If machinery and equipment for which a credit has been claimed is later moved to a higher-numbered tier, the credit is recomputed as if the machinery and equipment had been placed originally in the area to which it was moved.

g. Planned Expansion (G.S. 105-129.9(e))

A taxpayer that signs a letter of commitment with the Department of Commerce to place specific eligible machinery and equipment in service in an area within two years (seven years for interstate air couriers and eligible major industries) after the date the letter is signed may, in the year the eligible machinery and equipment are placed in service in that area, calculate the credit for which the taxpayer qualifies based on the area's enterprise tier and development zone designation for the year the letter was signed. If the taxpayer does not place part or all of the specified eligible machinery and equipment in service within the two-year period (seven years for interstate air couriers and eligible major industries), the taxpayer does not qualify for the benefit of the letter of commitment with respect to the machinery and equipment not placed in service within the two-year period (seven years for interstate air couriers and eligible major industries).

6. Credit for Technology Commercialization (G.S. 105-129.9A)

The credit for technology commercialization is similar to the credit for investing in machinery and equipment, but with higher rates of credit, and with more difficult eligibility requirements. Consequently, except as provided in this section, the provisions that apply to the credit for investing in machinery and equipment also apply to the technology commercialization credit. A taxpayer cannot take the machinery and equipment credit and the technology commercialization credit with respect to the same asset.

a. Eligibility

To be eligible for a technology commercialization credit, the taxpayer must meet all of the requirements for the credit for investing in machinery and equipment. In addition, the taxpayer must meet all of the conditions listed below:

- The eligible machinery and equipment must be directly related to production based on technology developed by and licensed from a research university; or be used to produce resources essential to the taxpayer's production based on technology developed by and licensed from a research university.
- The eligible machinery and equipment must be placed in service in a tier one, two, or three enterprise area.
- The eligible investment amount must be at least \$10,000,000 for the taxable year.
- If qualifying for a 20% credit, the taxpayer must invest at least \$150 million in eligible machinery and equipment by the end of the fourth year after the year in which eligible machinery and equipment are first placed in service in the area.
- If qualifying for a 15% credit, the taxpayer must invest at least \$100 million in eligible machinery and equipment by the end of the fourth year after the year in which eligible machinery and equipment are first placed in service in the area.
- No more than nine years has passed since the first taxable year the taxpayer claimed a technology commercialization credit with respect to the same location.

b. Terms Used

(1) Eligible Machinery and Equipment

Unlike the requirement for the credit for investing in machinery and equipment, a leased piece of machinery and equipment does not have to be capitalized in order to be "eligible" for this credit.

(2) Research University

An institution of higher education classified as a Research I university or a Research II university in the most recent edition of "A Classification of Institutions of Higher Education," the official report of The Carnegie Foundation for the Advancement of Teaching.

c. Credit Amount

The credit is a percentage of the excess of the eligible investment amount over the applicable threshold for the tax year. For a taxpayer whose level of investment is at least \$100 million, the percentage is 15%. If the level of investment is at least \$150 million, the percentage is 20%.

In calculating the eligible investment amount, machinery and equipment that were transferred to another taxpayer or were taken out of service during the three years preceding the tax year may be considered the taxpayer's machinery and equipment if certain conditions are met. See G.S. 105-129.9A(b) for the conditions. If the taxpayer wants to include machinery and equipment under the exception in G.S. 105-129.9A(b)(2), the taxpayer must first request a ruling by the Department of Revenue as to whether the taxpayer meets the conditions.

d. Taking the Credit

The credit is taken for the taxable year in which the machinery and equipment are placed in service. The credit is not taken in installments.

7. Credit for Worker Training (G.S. 105-129.11)

a. Eligibility

To be eligible for a credit for worker training, a taxpayer must:

- Meet all general eligibility requirements described in “General Eligibility Requirements” except for the wage standard test.
- Provide worker training for five or more of its eligible employees during the taxable year.

b. Terms Used

(1) Eligible Employee

An employee who is in a full-time position classified as non-exempt under the Fair Labor Standards Act and who meets one or more of the following conditions:

- The employee occupies a job for which the taxpayer is eligible to claim an installment of the credit for creating jobs.
- The employee is being trained to operate machinery and equipment for which the taxpayer is eligible to claim an installment of the credit for investing in machinery and equipment.

(2) Location of a Job

A job is located in an area if more than 50% of the employee's duties are performed in the area.

c. Credit Amount

The credit is equal to the wages paid to the eligible employees during the training. Wages paid to an employee performing his or her job while being trained are not eligible for the credit. For positions located in an enterprise tier one area, the credit may not exceed \$1,000 per employee trained during the taxable year. For positions located in other tiers, the credit may not exceed \$500 per employee trained during the taxable year.

d. Taking the Credit

The credit is taken during the taxable year the wages are paid to the eligible employees during training. The credit is not taken in installments.

8. Credit for Investing in Central Office or Aircraft Facility Property (G.S. 105-129.12)

a. Eligibility

To be eligible for the credit, a taxpayer must:

- Meet all of the general eligibility requirements described in “General Eligibility Requirements.”
- Purchase or lease real property in North Carolina.
- Begin to use the property as a central office or an aircraft facility during the taxable year.

b. Cost Defined

In the case of property owned by the taxpayer, cost is determined pursuant to regulations adopted under section 1012 of the Code. In the case of leased property, cost is considered to be the taxpayer's lease payments over a seven-year period, plus any expenditures made by the taxpayer to improve the property before it is used as the taxpayer's central office or aircraft facility if the expenditures are not reimbursed or credited by the lessor.

c. Credit Amount

The credit is 7% of the eligible investment amount. The eligible investment amount is the lesser of the following:

- The cost of the property.
- The amount by which the cost of all the property the taxpayer is using in North Carolina as central offices or aircraft facilities on the last day of the taxable year exceeds the cost of all the property the taxpayer was using in North Carolina as central offices or aircraft facilities on the last day of the base year. The base year is that year, of the three immediately preceding taxable years, in which the taxpayer was using the most property in North Carolina as central offices or aircraft facilities.

The maximum credit is \$500,000 per taxpayer. The basis in any real property for which a credit is allowed must be reduced by the amount of credit allowable.

d. Mixed Use Property

If the property is used for more than one purpose, the credit is allowed only with respect to the portion of the property that is used as a central office or aircraft facility. This determination is made using the following fraction:

$$\frac{\text{square footage of the property used as central office or aircraft facility}}{\text{total square footage of the property}}$$

e. Taking the Credit

The credit is taken in seven equal installments beginning the year after the taxpayer qualifies for the credit. If a taxpayer is required to file more than one tax return during a year, each return constitutes a year for purposes of taking installments of the credit.

f. Expiration

The credit expires in the following circumstances:

- When the property for which the credit is claimed is no longer used as a central office or an aircraft facility.
- When the total number of employees the taxpayer employs at all of its central offices or aircraft facilities in North Carolina drops below 40.
- When a portion of the property for which the credit is claimed is no longer used as a central office or an aircraft facility. In this circumstance, the amount of the credit associated with the portion no longer used as a central office or an aircraft facility expires. The remaining installments are computed by multiplying the total credit times the fraction described above for mixed-use property.

When a credit expires, the taxpayer can still take the portion of an installment that accrued in a previous year and was carried forward.

9. Credit for Substantial Investment in Other Property (G.S. 105-129.12A)

a. Eligibility

To be eligible for the credit, the taxpayer must receive a written determination from the Secretary of Commerce that the Secretary expects the taxpayer to purchase or lease and use in an eligible business at a specific location within a three-year period at least \$10,000,000 of real property, and to create 200 new jobs at that location within two years of the time that the property is first used in an eligible business. This requirement is set out in G.S. 105-129.4(b5). Additionally, the taxpayer must meet all of the eligibility requirements listed below:

- Meet all of the general eligibility requirements described in “General Eligibility Requirements.”
- Purchase or lease real property in an enterprise tier one or two area.
- Begin to use the property in an eligible business during the taxable year.

b. Terms Used

(1) Cost

In the case of property owned by the taxpayer, cost is determined pursuant to regulations adopted under section 1012 of the Internal Revenue Code. In the case of leased property, cost is considered to be the taxpayer's lease payments over a seven-year period, plus any expenditures made by the taxpayer to improve the property before the taxpayer uses it if the expenditures are not reimbursed or credited by the lessor.

(2) Property Located in an Enterprise Tier One or Two Area

Property is located in an enterprise tier one or two area if the area is designated as tier one or two at the time the taxpayer requests the required written determination from the Secretary of Commerce regarding its expected investment.

c. Credit Amount

The credit is 30% of the eligible investment amount. The eligible investment amount is the lesser of the following:

- The cost of the property.
- The amount by which the cost of all of the real property the taxpayer is using in this State in an eligible business on the last day of the taxable year exceeds the cost of all of the real property the taxpayer was using in this State in an eligible business on the last day of the base year. The base year is that year, of the three immediately preceding taxable years, in which the taxpayer was using the most real property in this State in an eligible business.

When an investment is phased in over the course of more than one tax year, the taxpayer may claim a credit in each year based on the eligible investment amount of the property that is first used in an eligible business for the current tax year. The basis in any real property for which a credit is allowed must be reduced by the amount of credit allowable.

d. Mixed Use Property

If the property is used for more than one purpose, the credit is allowed only with respect to the portion of the property that is used as a central office or aircraft facility. This determination is made using the following fraction:

$$\frac{\text{square footage of the property used as central office or aircraft facility}}{\text{total square footage of the property}}$$

e. Taking the Credit

The credit is taken in seven equal installments beginning the year after the taxpayer qualifies for the credit. If a taxpayer is required to file more than one tax return during a year, each return constitutes a year for purposes of taking installments of the credit.

f. Expiration

The credit expires in the following circumstances:

- When the property for which the credit is claimed is no longer used in an eligible business.
- When the total number of employees at the property with respect to which the credit is claimed drops below 200.
- When a portion of the property for which the credit is claimed is no longer used in an eligible business. In this circumstance, only the amount of the

credit associated with the portion no longer used in an eligible business expires. The remaining installments are computed by multiplying the total credit times the fraction described above for mixed-use property.

When a credit expires, the taxpayer may not take any remaining installments of the credit. The taxpayer can still take the portion of an installment that accrued in a previous year and was carried forward.

10. Credit for Development Zone Projects (G.S. 105-129.13)

a. Eligibility

The general eligibility requirements do not apply to this credit. To be eligible for a credit for a development zone project, the taxpayer must meet the following requirements:

- Contribute cash or property to a development zone agency for an improvement project in a development zone.
- Not control, be controlled by, or be under common control with an affiliate of the development zone agency. The taxpayer may not have one of the relationships defined in section 267(b) of the Internal Revenue Code with the development zone agency.
- File an application with the Department of Revenue on or before April 15 of the year following the calendar year in which the contribution was made. The Secretary may grant an extension for filing the application if a taxpayer makes a timely request for an extension. An extension allows the taxpayer to file the application by the following September 15.
- Include with an application submitted a certified appraisal of the value of the property contributed, if the contribution was of property rather than cash.

b. Terms Used

(1) Control

A person controls an entity if the person owns, directly or indirectly, more than 10% of the voting securities of that entity. The term "voting security" means a security that confers upon the holder the right to vote for the election of members of the board of directors or similar governing body of the business or is convertible into, or entitles the holder to receive upon its exercise, a security that confers such a right to vote. A general partnership interest is a voting security.

(2) Development Zone Agency

Any of the following agencies that the Department of Commerce certifies will undertake an improvement project in a development zone will qualify:

- A community-based development organization qualified under 24 C.F.R. section 570.204.
- A community action agency that has been officially designated as such pursuant to section 210 of the Economic Act of 1964, Public Law 88-452, 78 Stat. 508.
- A community development corporation.

- A community development financial institution certified by the United States Department of the Treasury under the Community Development Banking and Financial Institutions Act of 1994, 12 U.S.C. section 4701.
- A community housing development organization qualified under the HOME Investment Partnerships Act, 42 U.S.C. section 12701 and 12704, and 24 C.F.R. section 92.2.
- A local housing authority created under Article 1 of Chapter 157 of the General Statutes.

(3) Improvement Project

A project to construct or improve real property for community development purposes or to acquire real property and convert it for community development purposes. Construction or improvement includes services provided by a development zone agency directly related to the construction or improvement, and project development fees charged by a developer for the construction or improvement.

c. Credit Amount

The credit is equal to 25% of the value of the contribution of cash or property to a development zone agency for an improvement project in a development zone. A contribution is for an improvement project if the agency receiving the contribution contracts in writing to use the contribution for the project and agrees in the contract to repay to the taxpayer, with interest, any part of the contribution not used for the project.

d. Taking the Credit

The credit may not be taken in the year in which the contribution is made. Instead, the credit must be taken for the taxable year beginning during the calendar year in which the application to the Department of Revenue for the credit becomes effective.

e. Ceiling

The total amount of all credits for contributions made in a calendar year may not exceed \$4,000,000. If the total amount of credits claimed exceeds \$4,000,000, the Secretary of Revenue must allocate the \$4,000,000 in tax credits in proportion to the size of the credit claimed by each taxpayer. If a credit is reduced because of this ceiling, the Secretary must notify the taxpayer of the amount of the reduction of the credit on or before December 31 of the year the application was filed.

f. Forfeiture

A taxpayer forfeits the credit to the extent the development zone agency uses the taxpayer's contribution for any purpose other than an improvement project.

C. Business & Energy Tax Credits (Article 3B of Chapter 105)

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

Effective for taxable years beginning on or after January 1, 2005, 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.

a. 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.

b. 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.

c. 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.

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

Effective for taxable years beginning on or after January 1, 2006, 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 \$400,000,000 in the facilities is allowed a credit equal to 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 \$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 not take any remaining installment of the credit. The taxpayer may, however, take the portion of an installment that accrued in a previous year and was carried forward to the extent permitted under G.S. 105-129.17. If a credit allowed under this section expires, a taxpayer is not eligible for a credit under G.S. 105-129.16D(b) with respect to the same property.

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

e. 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 ~~credit~~credits allowed in this section with respect to the same costs.

f. Sunset (G.S. 105-129.16D(d))

The ~~credit~~credits allowed in this section ~~sunsets~~sunsets for facilities placed in service on or after January 1, ~~2008~~2011.

E. Historic Rehabilitation Tax Credits (Article 3D of Chapter 105)

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

a. Credit (G.S. 105-129.35(a), G.S. 105-129.37(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. Effective for taxable years beginning on or after January 1, 2006 for eligible sites placed into service on or after July 1, 2006, the tax credit allowed is 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. 105-241.1(i), computed from the date the taxes would have been due if the credit had not been allowed. The past taxes and interest are due 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 a copy of the certification obtained from the State Historic Preservation Officer verifying that the historic structure has been properly rehabilitated to the return.

3. Credit for Rehabilitating Non-income-Producing Historic Structure (G.S. 105-129.36)

a. Credit (G.S. 105-129.36(a), G.S. 105-129.36(b))

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. Effective for taxable years beginning on or after January 1, 2006 for eligible sites placed into service on or after July 1, 2006, the credit allowed is 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 24-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. The rehabilitation must be certified prior to the commencement of the work. Effective for taxable years beginning on or after January 1, 2006 for eligible sites placed into service on or after July 1, 2006, the rehabilitation is no longer required to be certified prior to the commencement of the work.

I. Credit for Mill Rehabilitation (Article 3H of Chapter 105)

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

Effective for taxable years beginning on or after January 1, 2006, a taxpayer that places eligible rehabilitated mill property into service on or after July 1, 2006 is allowed a credit against either franchise tax, corporate income tax or gross premiums tax. The taxpayer must elect the tax against which the credit is being claimed when filing the return on which the credit is claimed. The election is binding and any installments or carryforwards of the credit must be claimed against the same tax.

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. Sunset (G.S. 105-129.75)

The credit expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2011.

2. Definitions (G.S. 105-129.70)

a. Certified historic structure

Defined in section 47 of the Internal Revenue Code.

b. Certified rehabilitation

Defined in G.S. 105-129.36.

c. Cost certification

The certification obtained by the State Historic Preservation Officer from the taxpayer of the amount of the qualified rehabilitation expenditures or the rehabilitation expenses incurred with respect to an eligible site.

d. Eligibility certification

The certification obtained from the State Historic Preservation Officer that the applicable facility comprises an eligible site and that the rehabilitation is a certified rehabilitation.

e. Eligible site

A site located in this State that satisfies all of the following conditions:

- It was used as a manufacturing facility or for purposes ancillary to manufacturing, as a warehouse for selling agricultural products, or as a public or private utility.
- It is a certified historic structure or a State-certified historic structure.
- It has been at least 80% vacant for a period of at least two years immediately preceding the date the eligibility certification is made.
- The cost certification documents that the qualified rehabilitation expenditures for a site for which a taxpayer is allowed a credit under section 47 of the Code or the rehabilitation expenses for a site for which the taxpayer is not allowed a credit under section 47 of the Code exceed \$3,000,000 for the site as a whole.

f. Enterprise tier area

Defined in G.S. 105-129.3.

g. Pass-through entity

Defined in G.S. 105-228.90.

h. Qualified rehabilitation expenditures

Defined in section 47 of the Code.

i. Rehabilitation expenses

Defined in G.S. 105-129.36

j. State-certified historic structure

Defined in G.S. 105-129.36.

k. State Historic Preservation Officer

Defined in G.S. 105-129.36.

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

a. Credit

A taxpayer that is allowed a federal income tax credit under Code section 47 for making qualified rehabilitation expenditures with respect to 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:

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

b. Allocation

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least 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

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

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. 105-241.1(i) 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.

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

a. Credit

A taxpayer that is not allowed a federal income tax credit under Code section 47 and that makes qualified rehabilitation expenses with respect to 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 40% of qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of certification. No credit is allowed if the eligible site is in a tier four or five area.

b. Allocation

A pass-through entity that qualifies for the credit is allowed to allocate the credit among any of its owners in its discretion as long as an owner's adjusted basis in the pass-through entity at the end of the taxable year in which the eligible site is placed in service is at least 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

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

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. 105-241.1(i) 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 provided in G.S. 105-236.

V. EXCISE TAX
(Articles 2A, 2C, and 5E)

A. Tobacco Products Excise Tax (G.S. 105-113.2 – G.S. 105-113.40)

6. Use Tax Levied (G.S. 105-113.6)

A tax is levied upon the sale or possession for sale by a person other than a distributor, and upon the use, consumption, and possession for use or consumption of cigarettes within this State at the rate set in G.S. 105-113.5. This tax does not apply, however, to cigarettes upon which the tax levied in G.S.105-113.5 has been paid.

Railroads operating interstate are permitted to sell cigarettes by the pack, but such carriers must procure permission from the Secretary to sell cigarettes and must report all sales made within North Carolina to the Department on or before the 20th day of each month. The reports must be filed on forms prescribed by the Secretary and must state the amount of non-tax-paid cigarettes sold on the train in this State during the immediately preceding month. A remittance of the excise tax due the State on such sales must be submitted with the report. Railroads wishing to file the reports on other than a calendar month schedule must obtain approval from the Secretary before doing so.

Non-tax-paid cigarettes may be sold for use or consumption by or on ocean-going vessels which leave the continental United States and which ply the high seas in interstate or foreign commerce in the transport of freight or passengers for hire exclusively when delivered to an officer or agent of such vessel for use by or on such vessel accordingly. Receipt for delivery of such non-tax-paid cigarettes shall be signed for by an authorized officer or agent of such vessel, and such signed receipts shall be retained by the distributor for a period of three years; also, a copy of same shall be appended to the appropriate monthly tax report of the distributor. Only North Carolina tax-paid cigarettes may be sold by such vessels while in port or within the territorial limits of this State.

15. Payment of Tax and Required Reports (G.S. 105-113.18)

The taxes levied in this Part are payable when a report is required to be filed. The following reports are required to be filed with the Secretary:

a. Distributor's Report

A distributor shall file a monthly report in the form prescribed by the Secretary. The report covers sales and other activities occurring in a calendar month and is due within 20 days after the end of the month covered by the report. The report shall state the amount of tax due and shall identify any transactions to which the tax does not apply. Every licensed resident distributor shall file a report, Form B-A-5, on or before the 20th day of each month. Non-tax-paid cigarettes shipped, delivered, or sold outside the State during the month shall be reported on supplemental Form B-A-5, Schedule I. Cigarettes returned to the manufacturer during the month shall be reported on supplemental Form B-A-5, Schedule J.

Every licensed nonresident distributor shall file a report, Form B-A-6 on or before the 20th day of each month. Any licensed resident or nonresident distributor wishing to file the report or the form on other than a calendar month schedule must obtain approval from the Secretary before doing so.

b. Report of Free Cigarettes

A manufacturer who distributes cigarettes without charge shall file a monthly report in the form prescribed by the Secretary. The report covers cigarettes distributed without charge in a calendar month and is due within 20 days after the end of the month covered by the report. The report shall state the number of cigarettes distributed without charge and the amount of tax due.

c. Use Tax Report

Every other person who has acquired non-tax-paid cigarettes for sale, use, or consumption subject to the tax imposed by this Part must, within 96 hours after receipt of the cigarettes, file a report in the form prescribed by the Secretary showing the amount of cigarettes so received and any other information required by the Secretary. The report must be accompanied by payment of the full amount of the tax.

d. Shipping Report

Any person, except a licensed distributor, who transports cigarettes upon the public highways, roads, or streets of this State, upon notice from the Secretary, shall file a report in the form prescribed by the Secretary and containing the information required by the Secretary.

18. Reports and Records (G.S. 105-113.26, G.S. 105-113.30)

Every licensed distributor must file a report on or before the 20th day of each month with tax remittance on form prescribed by the Secretary showing transactions for the preceding month, and such other information as required by the report. Monthly reports are required whether or not any tax is shown to be due. Each licensed distributor wishing to file the report or the form on other than a calendar month schedule must obtain approval from the Secretary before doing so.

Distributors who operate in a period, other than a calendar month, must provide the Tobacco Products Excise Tax Unit of the Department a list of the period ending dates for each coming year. This period ending schedule is due in November of each year unless advised otherwise. The cigarette monthly report is due within 20 days after the particular period ends.

Every person required to be licensed under this Article and every person required to make reports under this Article shall keep complete and accurate records of all sales and other information as required under this Article. The records shall be in the form prescribed by the Secretary. These records shall be safely preserved for a period of three years in a manner to ensure their security and accessibility for inspection by the

Department. The Secretary may consent to the destruction of any records at any time within this three-year period.

It shall be unlawful for any person who is required under the provisions of this Article to keep records or make reports, to fail to keep such records, refuse to keep such reports, make false entries in such records, fail to produce such records for inspection by the Secretary or his duly authorized agents, fail to file a report, or make a false or fraudulent report or statement.

Each sale of cigarettes at wholesale, including cash and credit transactions, and regardless of whether the sale is made to another distributor, wholesale dealer, retail dealer, or is a transfer to a self-owned outlet or an agency or agent, must be accompanied by a completed invoice indicating the person to whom the cigarettes were sold, the address of the purchaser, the date of the sale, the quantity sold, and the price charged.

Sales invoices of distributors, whether resident or nonresident, must indicate payment of the excise tax by the wording, "North Carolina Cigarette Excise Tax Paid."

If a distributor is also a retail dealer and sells cigarettes to consumers, an invoice or a memorandum must be prepared showing the transfer of all cigarettes from the distributor to the retail activity. Cigarette excise tax is applicable at the point of transfer and the required documents must reflect payment of the tax by the wording, "North Carolina Cigarette Excise Tax Paid."

27. Payment of Tax (G.S. 105-113.37)

Except for tax on sales designated as tax-exempt under G.S. 105-113.35, the taxes levied by this Article are payable when a report is required to be filed. Monthly reports covering sales and other activities occurring in a calendar month are due within 20 days after the end of the month covered by the report. Each report must be filed on a form provided by the Secretary and must contain the information required by the Secretary. A return must be filed each month even if no tax is due for that month. Any wholesale dealer selling designated other tobacco products wishing to report sales and other activities occurring in the report period on other than a calendar month schedule must obtain approval from the Secretary before doing so.

Wholesale dealers and retail dealers who operate in a period other than a calendar month, must provide the Tobacco Products Excise Tax Unit of the Department a list of the period ending dates for each coming year. This period ending schedule is due in November of each year unless advised otherwise. The other tobacco products monthly report and tax remittance are due within 20 days after the particular period ends.

Sales invoices of wholesale dealers, whether resident or nonresident, liable for the tax must indicate payment of the excise tax on other tobacco products by the wording "North Carolina Other Tobacco Products Tax Paid."

All sales invoices of nonresident wholesale dealers must show the point of origin and mode of transportation for all shipments of other tobacco products into this State.

A wholesale dealer who sells a tobacco product to a person who has notified the wholesale dealer in writing that the person intends to resell the item in a transaction that is exempt from tax under G.S. 105-113.35(a)(1) or (2) may, when filing a monthly report, designate the quantity of tobacco products sold to the person for resale. A wholesale dealer must report all designated sales during a taxable period on Form B-A-101. The wholesale dealer must separately invoice and indicate the other tobacco products designated for exempt transactions. For example, sales designated for customers with other tobacco product sales outside North Carolina must be invoiced to read, "Designated for Sale Outside North Carolina". A wholesale dealer is not required to pay tax on a designated sale when filing a monthly report. However, where prior written notification is not provided, the wholesale dealer must remit applicable tax.

The wholesale dealer must pay the tax due on all other sales in accordance with this section. A wholesale dealer or a customer of a wholesale dealer may not delay payment of the tax due on a tobacco product by failing to pay tax on a sale that is not a designated sale or by overstating the quantity of tobacco products that will be resold in a transaction exempt under G.S. 105-113.35(a)(1) or (2).

A person who does not sell a tobacco product in a transaction exempt under G.S. 105-113.35(a)(1) or (2) after a wholesale dealer has failed to pay the tax due on the sale of the item to the person in reliance on the person's written notification of intent is liable for the tax and any penalties and interest due on the designated sale. If the Secretary determines that a tobacco product reported as a designated sale is not sold as reported, the Secretary will assess the person who notified the wholesale dealer of an intention to resell the item in an exempt transaction for the tax due on the sale and any applicable penalties and interest. A wholesale dealer who does not pay tax on a tobacco product in reliance on a person's written notification of intent to resell the item in an exempt transaction is not liable for any tax assessed on the item.

The tax liability plus penalties and interest will be held against the wholesaler's customer who sells other tobacco products designated exempt in a taxable transaction. Customers violating designation procedures can expect full penalties to be held on designated products improperly handled.

Once other tobacco products are designated as tax exempt under G.S. 105-113.35, they must be sold in tax-exempt transactions.

C. Piped Natural Gas Excise Tax (G.S. 105-187.41)

3. Due Date of the Report and Tax

The returns are required quarterly and are due by the last day of the month following the end of the calendar quarter. The quarterly return will include, (a) the piped

natural gas delivered during the quarter to sales or transportation customers in each city in the State and, (b) the piped natural gas received during the month in each city in the State by persons who have direct access to an interstate gas pipeline and who receive the gas for their own consumption.

Tax on gas delivered through the end of 2001 is due monthly by the last day of the month that follows the month in which the tax accrues. Payments of tax by EFT are required if the average amount of tax is at least \$20,000 a month.

Effective January 1, 2002, a taxpayer must pay the piped natural gas excise tax in accordance with the same schedule by which it pays sales and use tax. A semimonthly payment for the period from the first of the month to the 15th day of the month is due by the 25th of the month. A semimonthly payment that covers the period from the 16th day of the month to the end of the month is due by the 10th day of the following month. All semimonthly payments are required to be paid by EFT. The taxpayer is not subject to penalties for a semimonthly or monthly amount due if the taxpayer timely pays at least 95% of the amount due and includes the underpayment with the quarterly return for those semimonthly or monthly payment periods.

Effective October 1, 2007, the piped natural gas tax is payable monthly, on the 20th day of the month following the calendar month in which the tax liability for the tax accrues. In addition, if a taxpayer's piped natural gas tax liability is consistently at least \$10,000 per month, the taxpayer must prepay the next month's tax liability at the same time that it is paying the current month's liability. The prepayment must equal at least sixty-five percent (65%) of any of the following:

- The amount of tax due for the current month.
- The amount of tax due for the same month in the preceding year.
- The average monthly amount of tax due in the preceding calendar year.

VI. PRIVILEGE TAXES (Article 2)

D. Amusements – Certain Exhibitions, Performances, and Entertainment Exempt (G.S. 105-40)

The following forms of amusements are exempt from the taxes imposed under Article 2 of Chapter 105 of the General Statutes:

1. All exhibitions, performances, and entertainments, except those expressly mentioned in Article 2 as not exempt, produced by local talent exclusively, for the benefit of religious, charitable, benevolent or educational purposes, as long as no compensation is paid to the local talent.
2. The North Carolina Symphony Society, Incorporated, as specified in G.S. 140-10.1.
3. All exhibits, shows, attractions, and amusements operated by a society or association organized under the provisions of Chapter 106 of the General Statutes where the society or association has obtained a permit from the Secretary to operate without the payment of taxes under Article 2.
4. All outdoor historical dramas, as specified in Article 19C of Chapter 143 of the General Statutes.
5. All elementary and secondary school athletic contests, dances, and other amusements.
6. The first one thousand dollars (\$1,000) of gross receipts derived from dances and other amusements *actually promoted and managed* by civic organizations when the entire proceeds of the dances or other amusements are used exclusively for civic and charitable purposes of the organizations and not to defray the expenses of the organization conducting the dance or amusement. The exemption applies separately to each dance or other amusement (17 NCAC 04B.0306). The mere sponsorship of a dance or another amusement by a civic or fraternal organization does not exempt the dance or other amusement, because the exemption applies only when the dance or amusement is *actually managed and conducted* by the civic or fraternal organization.
7. A youth athletic contest with an admissions price that does not exceed ten dollars (\$10.00) sponsored by a person exempt from income tax under Article 4 of this Chapter. For the purpose of this subdivision, a youth athletic contest means a contest in which each participating athlete is less than 20 years of age.
8. All dances, motion picture shows, and other amusements promoted and managed by a qualifying corporation that operates a center for the performing and visual arts

- if the dance or other amusement is held at the center. “Qualifying corporation” means a corporation that is exempt from income tax under G.S. 105-130.11(a)(3). “Center for the performing and visual arts” means a facility, having a fixed location, that provides space for dramatic performances, studios, classrooms, and similar accommodations to organized arts groups and individual artists. This exemption does not apply to athletic events.
9. All exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from income tax under G.S. 105-130.11(a)(3). This exemption does not apply to athletic events.
 10. A person that is exempt from income tax under Article 4 of Chapter 105 and is engaged in the business of operating a teen center. A “teen center” is a fixed facility whose primary purpose is to provide recreational activities, dramatic performances, dances, and other amusements exclusively for teenagers.
 11. All entertainment or amusements offered or given on the Cherokee Indian reservation when the person giving, offering, or managing the entertainment or amusement is authorized to do business on the reservation and pays the tribal gross receipts levy to the tribal council.
 12. Arts festivals held by a person that is exempt from income tax under Article 4 of Chapter 105 and that meets the following conditions:
 - The person holds no more than two arts festivals during a calendar year.
 - Each of the person's arts festivals last no more than seven days.
 - The arts festivals are held outdoors on public property and involve a variety of exhibitions, entertainments, and activities.
 13. Community festivals held by a person who is exempt from income tax under Article 4 of Chapter 105 and that meets all of the following conditions:
 - The person holds no more than one community festival during a calendar year.
 - The community festival lasts no more than seven days.
 - The community festival involves a variety of exhibitions, entertainments, and activities, the majority of which are held outdoors and are open to the public.
 14. All farm-related exhibitions, shows, attractions, or amusements offered on land used for bona fide farm purposes as defined in G.S. 153A-340. Bona fide farm purposes include the production and activities relating or incidental to the production of crops, fruits, vegetables, ornamental and flowering plants, dairy,

livestock, poultry, and all other forms of agricultural products having a domestic or foreign market. The production of a nonfarm product that the Department of Agriculture and Consumer Services recognizes as a "Goodness Grows in North Carolina" product that is produced on a farm subject to a conservation agreement under G.S. 106-743.2 is a bona fide farm purpose."

15. An admission charge to a fishing pier is not subject to the tax if the charge is for fishing on the pier. (17 NCAC 04B.0310)

**VII. INSURANCE PREMIUM TAX
(Article 8B)**

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

Tax rates and charges are as follows:

Workers' Compensation	2.50%
Other taxable contracts	1.90%
Additional Statewide Fire and Lightning (excluding auto and marine)	1.33%
Additional Local Fire and Lightning	.50%
Article 65 Corporations	1.90%
Health Maintenance Organizations (2004-2006)	1.00%
Insurance Regulatory Charge (2005 2006)	5.50%*

*Subject to change each year and is established by the General Assembly based on a proposed percentage rate submitted by the NC Department of Insurance sufficient to defray the estimated cost of the operations of the NC Department of Insurance for each upcoming fiscal year.

F. Retaliatory Provisions (G.S. 105-228.8)

When the laws of any other state impose, or would impose, any premium taxes, upon North Carolina companies doing business in the other state that are, on an aggregate basis, in excess of the premium taxes directly imposed upon similar companies by the statutes of this State, the Secretary of Revenue shall impose the same premium taxes, on an aggregate basis, upon the companies chartered in the other state doing business or seeking to do business in North Carolina. Retaliatory tax is reported and paid with the annual Gross Premium Tax return. Special purpose obligations or assessments based on premiums imposed in connection with particular kinds of insurance, the special purpose regulatory charge and dedicated special purpose taxes based on premiums are excluded from retaliatory computations. Seventy-five percent (75%) of the Additional Statewide Fire and Lightning tax is included in the retaliatory computations.

If an insurer changes its state of domicile during the calendar year, the retaliatory tax should be calculated taking into account the portion of the year the company was domiciled in each state, respectively. For example, Company B is chartered in State A from January 1 through July 31, but changes its state of domicile to State B, effective August 1. The retaliatory calculation should reflect the taxes and includable fees and assessments charged by State A for business done for the period January 1 through July 31 and the taxes and includable fees and assessments charged by State B for business done for the period August 1 through December 31. Appropriate documentation

supporting the retaliatory calculation must be attached to the gross premium tax return for the calendar year.

K. Tax Credits (G.S. 105-228.5A, G.S. 97-29.1, G.S. 105-129.16B, Article 3A of Chapter 105, Article 3H of Chapter 105)

1. Guaranty Assessment Credits

North Carolina Guaranty Association assessments paid by insurers may be used as a credit against premium tax. The credit is 20% per year for a period of five years beginning with the year after payment of the assessment. The credit applies to all Insurance Guaranty Association and Life and Accident and Health Insurance Guaranty Association assessments paid. The credit may not exceed the premium tax liability for the year. Self-Insured Guaranty Association assessments paid may be applied as a 100% credit for the year in which it is paid.

2. Supplemental Workers' Compensation Credits

Supplemental workers' compensation benefits paid to NC residents may be applied as a credit.

3. Tax Incentive Credits

Tax credits provided under Article 3A are allowed to be taken against gross premiums tax. The Article 3A credits are the tax incentives for new and expanding businesses. These various credits can be taken against the gross premiums tax effective for taxable years beginning on or after January 1, 1999. Article 3A is set to expire for taxable years beginning on or after January 1, 2007.

4. Tax Credit for Low-income Housing

Effective for taxable years beginning on or after January 1, 2001, for buildings placed in service on or after that date, the tax credit for low-income housing may be taken against gross premium tax. See "Credit for Low-income Housing" in the "Credits" section for further information about this credit.

5. Tax Credit for Mill Rehabilitation

Effective for taxable beginning on or after January 1, 2006, the tax credit for mill rehabilitation may be taken against gross premium tax. See "Credit for Mill Rehabilitation" in the "Credits" section for further information on this credit.

VIII. GENERAL ADMINISTRATION
(Article 9)

C. Penalties and Interest (G.S. 105-228.90 through G.S. 105-236, G.S. 105-241.1, G.S. 105-253)

3. Penalty for Bad Check

When any uncertified check submitted to the Department of Revenue by a taxpayer is returned because of insufficient funds or the nonexistence of an account of the drawer, a penalty equal to ten percent (10%) of the check is assessed. The penalty shall not be less than one dollar (\$1.00) or more than one thousand dollars (\$1,000). This penalty does not apply if the Secretary finds that, when the check was presented for payment, the drawer of the check had sufficient funds in an account at a financial institution ~~in this State~~ to pay the check and, inadvertently, failed to draw the check on the account that had sufficient funds.