



MULTISTATE INCOME/FRANCHISE TAX

North Carolina issues guidance on pass-through entity tax Tax Alert

Overview

On April 14, 2022 (updated April 27, 2022), the North Carolina Department of Revenue (the “DOR”) released [Important Notice Regarding North Carolina’s Recently Enacted Pass-Through Entity Tax](#) (the “Notice”). The Notice provides answers to frequently asked questions (“FAQs”) regarding the North Carolina pass-through entity tax (the “NC PET”), which allows certain pass-through entities to elect to pay an entity level state income tax for taxable years beginning on or after January 1, 2022. See our previously issued [Tax Alert](#) from December 2, 2021 for more details about this tax.

This Tax Alert summarizes some of the new NC PET guidance from the Notice.

General North Carolina pass-through entity tax information

The NC PET is effective for taxable years beginning on or after January 1, 2022, for partnerships or S corporations. The Notice provides answers to FAQs related to the implementation of the NC PET. In addition to summarizing the provisions of the NC PET, the Notice provides additional guidance including general information, owner level reporting implications, and information on the credit for income taxes paid to another state.

Election mechanics

- The NC PET election is made on a timely filed annual North Carolina tax return, including extensions. A NC PET election on a late-filed North Carolina tax return is not valid.
- An electing entity may revoke the election if an authorized person requests the revocation prior to the due date of the North Carolina tax return, including any extensions.

North Carolina return filing requirements

- An electing pass-through entity may file its North Carolina tax return (and remit tax payments) electronically if using an approved e-File software provider.

- When an electing pass-through entity files a North Carolina tax return reflecting an overpayment due, the DOR must refund the overpayment to the electing pass-through entity. Only the electing pass-through entity, not its owners, are entitled to request a refund of an overpayment.
- An electing pass-through entity must also report to its owners the following:
 - That it made the election;
 - The amount of the owner's share of income or loss from the electing pass-through entity to the extent it was included in the pass-through entity's North Carolina taxable income; and
 - The amount of tax paid by the electing pass-through entity on the owner's share of the electing pass-through entity's North Carolina taxable income.

Estimated income tax payments

- An electing pass-through entity that can reasonably expect to have a North Carolina income tax liability of at least \$500 is required to pay estimated tax payments in the same manner as a C corporation. To make an estimated payment, an electing pass-through entity must use [Form NC-429 PTE](#), Pass-through Entity Estimated Income Tax voucher.
- A pass-through entity that plans to make the NC PET election in tax year 2022 may voluntarily pay North Carolina income tax based on the estimated net income of the pass-through entity.
- Electing pass-through entities will not be subject to interest for underpayment of estimated income tax for tax year 2022.

Pass-through entity owner reporting requirements

Estimated income tax payments

- If an owner of a pass-through entity excludes the owner's share of income from the pass-through entity in the owner's calculation of North Carolina estimated tax for tax year 2022, the owner will not owe estimated tax interest on the owner's share of the pass-through entity's income so long as the pass-through entity does the following:
 - Meets the statutory requirements to be eligible to make the NC PET election for tax year 2022; and
 - Makes the NC PET election on its North Carolina tax return for tax year 2022.
- If a pass-through entity decides not to make the NC PET election during tax year 2022, the owners of the pass-through entity may be eligible to use the annualized installment method for calculating estimated tax installments.

North Carolina return filing requirements

- Adjustments required in the calculation of the NC PET must also be passed through and reported on the owners' North Carolina tax returns.
- If an electing pass-through entity does not pay the full amount of tax it owes, the DOR must collect the tax due from the pass-through entity. However, if the electing pass-through entity fails to pay the full amount of tax due within 60 days of being notified of the outstanding liability, the owners of the electing pass-through entity are not eligible to take a deduction for the owners' distributive share of income from the pass-through entity. The

DOR will send the owners a Notice of Proposed Assessment for the tax year disallowing the deduction for the owners' share of income from the electing pass-through entity.

Nonresident owners of electing pass-through entities

- A nonresident shareholder in an electing S corporation is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the owner's share of S corporation income and the S corporation complied with the provisions of the NC PET.
- A nonresident individual partner in an electing partnership is not required to file a North Carolina individual income tax return when the only income from North Carolina sources is the nonresident's share of income from a partnership doing business in North Carolina, and the manager of the partnership has reported the income of the nonresident partner, including any guaranteed payments made to the partner, and complied with the provisions of the NC PET.
- If the Secretary believes that an individual is liable for North Carolina individual income tax, the Secretary may require the individual to file a North Carolina tax return with the DOR.

North Carolina credit for income taxes paid to another state

- North Carolina resident owners of an electing partnership or S corporation may not claim a tax credit on their North Carolina returns for income taxes paid to another state on income that is taxed to the electing entity. Instead, the electing partnership or S corporation is allowed a tax credit against its North Carolina income taxes as long as the electing entity was subject to and paid income tax to another state on income that was taxed to the entity with respect to its resident owners.
- If an electing entity is not taxed at the entity level in another state where the entity does business and a North Carolina resident owner pays income tax to the other state on their share of income from the electing pass-through entity, the North Carolina resident owner may be allowed a tax credit for income taxes paid to another state.
- If a pass-through entity does not make the NC PET election, but elects or is required to pay income tax at the entity level under the laws of another state, North Carolina does not provide a mechanism for the pass-through entity to claim a North Carolina tax credit for income taxes the pass-through entity paid to the other state. Whether a North Carolina resident owner may be eligible to claim a credit for income taxes paid to the other state by the pass-through entity depends on the entity type.
 - For S corporations: Each North Carolina resident shareholder is considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's pro rata share of any net income tax paid by the S Corporation. A North Carolina resident shareholder may be eligible to claim a tax credit for entity-level income taxes paid by the S corporation to the other state.
 - For partnerships: There is no provision in North Carolina law that allows a North Carolina resident partner of a partnership to claim a tax credit for entity-level income taxes paid by the partnership to another state. Consequently, a North Carolina resident partner cannot claim a credit on the partner's NC Tax Return for entity-level income taxes paid by the partnership to the other

state.

The Notice states that the DOR will release additional guidance in the 2022 North Carolina tax return instructions.

Get in touch

[Art Tilley](#)

Have a question relating to this or any other pass-through entity tax regime? Reach out to one of our national multistate pass-through entity tax specialists.

[Todd Hyman](#)

[Greg Bergmann](#)

[Robert Waldow](#)

[Shirley Wei](#)

[Hernan Stigliano](#)

[Andrew Cardaci](#)

[Dan Daly](#)

[Jason Kang](#)

[Fiona Pan](#)

[Amanda Sterling](#)

[Alyssa Keim](#)

[Olivia Schulte](#)

[George Yu](#)



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30 Rockefeller Plaza
New York, NY 10112-0015
United States

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