

North Carolina Tax Legislation Enacted

Overview

On June 12, 2018, the North Carolina General Assembly overrode Governor Roy Cooper's veto of Senate Bill 99 (S.B. 99)¹ - thereby enacting S.B. 99 into law which impacts state income, franchise, and sales and use taxes. S.B. 99 includes the following significant modifications to North Carolina law which are effective immediately unless specified otherwise.

Internal Revenue Code conformity update

- Updates the North Carolina income tax code to conform to the Internal Revenue Code (IRC) as of February 9, 2018 for both for both corporate and individual income tax purposes.

Corporate income and franchise tax amendments

- Modifies certain additions and subtractions from federal taxable income to arrive at North Carolina net income in response to federal tax reform.
- Revises certain language related to the determination of net worth.
- Modifies and clarifies certain provisions related to the sales factor.

Reporting considerations for corporate and individual taxpayers

- Clarifies the filing requirements as a result of federal income tax return changes and adjustments.
- Provides for an automatic extension of time to file tax returns effective for taxable years beginning on or after January 1, 2019.

Sales and use tax amendments

- Clarifies the manner in which sales and use tax is imposed on repair, maintenance, and installation (RMI) services relative to the tangible personal property element of the RMI.
- Provides a mechanism for retailers to recover certain sales and use taxes paid.

This tax alert summarizes the more significant North Carolina tax law changes contained in S.B. 99 and provides some taxpayer considerations.

IRC conformity update

S.B. 99 updates North Carolina's general conformity to the IRC "as enacted as of February 9, 2018, including any provisions enacted as of that date that become effective either before or after that date"² for state income tax purposes. The recent amendments to the IRC resulting from federal tax reform are now applicable for North Carolina corporate and individual income tax purposes for the 2017 and later tax years as a result of this amended IRC reference.

Corporate income and franchise tax amendments

Adjustments to federal taxable income in determining North Carolina net income

S.B. 99 decouples from various elements of federal tax reform by modifying the adjustments to federal taxable income in determining North Carolina net income. S.B. 99 amends the *subtractions* from federal taxable income that shall be made by a corporation in determining North Carolina net income to include subtractions for amounts included in federal taxable income under IRC Sections 78, 951, 951A, or 965, net of related expenses.³ (Previously N.C. Gen. Stat. Section 105-130.5(b)(3b) provided for a deduction for the amounts included under IRC Sections 78 and 951.) In addition, S.B. 99 amends the *additions* to federal taxable income that shall be made in determining North Carolina net income to include additions for amounts deducted under IRC Section 250⁴ as well as IRC Section 965(c).⁵

¹ Session Law 2018-5 (S.B. 99). A copy of the law is available [here](#).

² S.B. 99, Sec. 38.1(a), amending N.C. G.S. § 105-228.90(b)(1b).

³ S.B. 99, Sec. 38.1(b), amending N.C. G.S. § 105-130.5(b)(3b).

⁴ S.B. 99, Sec. 38.1(b), adding N.C. G.S. § 105-130.5(a)(28).

⁵ S.B. 99, Sec. 38.1(b), adding N.C. G.S. § 105-130.5(a)(29).

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S.B. 99 also amends the North Carolina net income tax base to require addition/subtractions necessary to decouple from the newly enacted Opportunity Zone provisions under IRC Section 1400Z-2.⁶

Determination of net worth

S.B. 99 amends the definition of "corporation" for purposes of the application of the franchise tax to include partnerships that elect to be taxed as a corporation for income tax purposes.⁷ Prior to this change, the definition of "corporation" included limited liability companies that elected to be taxed as corporations, but did not include partnerships that elected to be taxed as corporations.

In addition, S.B. 99 eliminates certain language affecting the determination of net worth and prevents a double deduction of treasury stock already captured in the current calculation.⁸

These changes are both effective for franchise tax years beginning on or after January 1, 2019 (i.e., franchise tax reported on 2018 and later returns).

Sales factor amendments

S.B. 99 modifies how receipts from intangible property are sourced to North Carolina, such that receipts are now sourced to North Carolina to the extent the intangible property *is used in North Carolina*. Previously, gross receipts from intangible property were sourced to North Carolina if received from sources in North Carolina.

Receipts from services are still sourced to North Carolina based on the proportion of income-producing activities performed in North Carolina. S.B. 99 amends N.C. Gen. Stat. Section 105-130.4 to define income-producing activity as "an activity directly performed by the taxpayer or its agents for the ultimate purpose of generating the sale of the service." Receipts from income-producing activities performed within and without the State are attributed to the State in proportion to the income-producing activities performed in the State to the total income-producing activities performed everywhere that generate the sale of service.⁹ Previously the term was not explicitly defined.

The amended apportionment provisions are applicable for both corporate income and franchise tax purposes.

Reporting considerations for corporate and individual taxpayers

Federal determinations and amended returns

Under current law, a taxpayer must file an amended return with the North Carolina Department of Revenue within 6 months after a federal determination, regardless of whether the amount owed is increased or decreased. S.B. 99 defines what constitutes a "final determination"¹⁰ and provides that if a taxpayer voluntarily files an amended federal return, the taxpayer is required to file an amended North Carolina return if it results in additional tax payable.¹¹ An amended North Carolina return is optional if the taxpayer voluntarily files an amended federal return and the adjustments result in less North Carolina tax owed.¹²

Automatic extension

Currently, taxpayers seeking an extension of time to file must file a North Carolina tax extension form. S.B. 99 provides that any taxpayer granted an extension of time for filing a federal income tax return is granted an automatic extension of time to file the corresponding North Carolina income and franchise tax return.¹³ This change becomes effective for taxable years beginning on or after January 1, 2019.¹⁴

Sales and use tax amendments

Taxation of repair, maintenance, and installation services

S.B. 99 clarifies that the subdivision regarding the tax imposed on retailers and certain facilitators applies to the sales price of or gross receipts derived from RMI services as it relates to the tangible personal property element of the RMI.¹⁵ Previously, the taxation of the tangible personal property and the taxation of RMI were levied separately and these two provisions are now merged.

⁶ S.B. 99, Sec. 38.1(b), adding N.C. G.S. § 105-130.5(a)(26) & (27) and N.C. G.S. § 105-130.5(b)(29).

⁷ S.B. 99, Sec. 38.2(a), amending N.C. G.S. § 105-114(b)(2).

⁸ S.B. 99, Sec. 38.2(b), amending N.C. G.S. § 105-122(b).

⁹ S.B. 99, Sec. 38.2(c), amending N.C. G.S. § 105-130.4(l)(3)(c).

¹⁰ S.B. 99, Sec. 38.3(g), adding N.C. G.S. § 105-228.90(b)(3a).

¹¹ S.B. 99, Sec. 38.3(a), adding N.C. G.S. § 105-130.20(b)(1).

¹² S.B. 99, Sec. 38.3(a), adding N.C. G.S. § 105-130.20(b)(2).

¹³ S.B. 99, Sec. 38.4(a), adding N.C. G.S. § 105-263(c).

¹⁴ S.B. 99, Sec. 38.4(b).

¹⁵ S.B. 99, Sec. 38.5(c), amending N.C. G.S. § 105-164.4(a)(1).

Retailer recovery of sales and use tax paid

During the 2017 session, the North Carolina General Assembly provided a temporary means for a retailer to recover sales and use tax originally paid on an item subsequently resold. S.B. 99 adds a new section to provide for a permanent mechanism. A retailer entitled to recover tax may reduce taxable receipts by the taxable amount of the purchase price of the property or services resold for the period in which the retail sale occurs.¹⁶ The recovery cannot create a refund, but may be carried forward to a subsequent reporting period and taken as an adjustment to taxable receipts.¹⁷

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This tax alert does not provide a comprehensive summary of all tax law changes contained in S.B. 99. In addition to the various changes highlighted above, S.B. 99 amends other state sales and use tax provisions, as well as certain individual income tax, excise tax and corporate income tax provisions that are beyond the scope of this tax alert.

Taxpayer considerations

As noted above, the updated IRC reference is applicable to both corporate and individual taxpayers filing North Carolina tax returns. North Carolina individual income tax provisions do not provide for an exclusion for foreign dividends for individual income tax purposes and S.B. 99 did not otherwise decouple from the international aspects of federal tax reform that potentially affect individual taxpayers. Taxpayers who filed a 2017 North Carolina tax return prior to the enactment of S.B. 99 should determine if an amended North Carolina tax return may be required.

Corporate taxpayers should also review the effects the new law may have on their state tax obligations in North Carolina with regard to the changes to the apportionment factor provisions, and the computation of net worth. Taxpayers are advised to consult with their North Carolina tax advisors for further assistance.

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¹⁶ S.B. 99, Sec. 38.5(h), adding N.C. G.S. § 105-164.11B.

¹⁷ *Id.*

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