Williams Overman Pierce, LLP
Certified Public Accountants and Consultants

North Carolina FY ’19 Budget Bill Enacts Major Corporate Income Tax Legislation

Summary

On June 12, following on the North Carolina Senate’s June 7, 2018, vote to override the Governor’s veto, the House also voted to override the Governor’s veto of S.B. 99, North Carolina FY ’19 budget bill. As a result of the North Carolina General Assembly’s actions, S.B. 99 has been enacted and becomes effective on July 1, 2018. The budget bill updates North Carolina’s Internal Revenue Code (IRC) conformity date, reacts to a number of the federal tax reform provisions enacted as part of the Tax Cuts and Jobs Act, modifies the sourcing of receipts from services and intangibles for purposes of the sales factor, and makes a number of procedural changes for North Carolina income tax purposes.

Details

North Carolina Reactions to Federal Tax Cuts and Jobs Act

Among other provisions, S.B. 99 makes the following North Carolina income tax changes related to federal tax reform (for corporate income tax and personal income tax purposes):

- Updates North Carolina’s IRC conformity date from the IRC “as enacted as of” January 1, 2017, 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.” As a result, this would entail IRC section 965 (but see next), as well as IRC section 168(k), although North Carolina preserved its decoupling from federal bonus depreciation.
- For corporate income tax purposes only, S.B. 99 provides a subtraction modification adjustment to the federal taxable income starting point for IRC section 965(a) deemed repatriation income and IRC section 951A global intangible low-taxed income (GILTI). However, the IRC section 965(c) participation exemption deduction and the IRC section 250 foreign derived intangible income (FDII) must be added back to the North Carolina federal taxable income starting point (of a corporation).
    - It is important to note that the subtraction of IRC section 965(a) income and IRC section 951A GILTI is net of related expenses (i.e., related expenses cannot be deducted for North Carolina income tax purposes).
- Gain that is deferred for federal tax purposes as a result of new IRC section 1400Z-2(b) (which allows taxpayers to elect to defer inclusion of gain on a sale or exchange of property if the proceeds are reinvested in a qualified state opportunity zone) must be added to North Carolina’s federal taxable income starting point of a corporation or the adjusted gross income starting point of an individual. That is, North Carolina decouples from the federal gain deferral. Once the gain is recognized for federal purposes, S.B. 99 then provides a subtraction modification, as the gain was already previously taxed for North Carolina income tax purposes.

Modification and Clarification of North Carolina Sales Factor

For corporate income tax purposes under current law, gross receipts from sales of services are sourced to North Carolina if the “income-producing activities” are in North Carolina. Under current law, gross receipts from intangible property are sourced to North Carolina if received from sources in North Carolina. While most states are adopting the market-based sourcing trend, S.B. 99 retains North Carolina’s “income-producing activities” sourcing standard for sales of services. S.B. 99 first clarifies that receipts from intangibles will now be sourced to North Carolina to the extent the intangible property is used in North Carolina.

With respect to gross receipts from sales of services, S.B. 99 makes the following changes:

- "Income-producing activity" is now defined to mean an "activity directly performed by the taxpayer or its agents for the ultimate purpose of generating the sale of the service."
- If the "income-producing activity" is performed within and without North Carolina, the receipts are sourced to North Carolina in proportion to the income-producing activities performed in North Carolina to total income-producing activities performed everywhere that generate the sale of the service.

Tax Return and Procedural Amendments

S.B. 99 enacts the following income tax return and procedural amendments:

- Effective for tax years beginning on or after January 1, 2019, an automatic North Carolina tax return filing extension will be granted to all taxpayers, including partnerships, if the taxpayer receives a federal extension.
- S.B. 99 changes the reporting of federal audit adjustments, including timing, as follows:
  - If the federal adjustment increases the amount of North Carolina income tax payable, the taxpayer must file an amended North Carolina return within six months after being notified of each federal change or correction.
  - If the federal adjustment decreases the amount of North Carolina income tax payable, the taxpayer has within the refund limitations period to file an amended North Carolina tax return.
  - The requirements also apply to fiduciaries, employers, pension payers, and other persons required to withhold North Carolina income taxes.
  - Taxpayers who fail to comply are subject to penalties set forth in N.C. Gen. Stat. section 105-236, including failure to file, failure to pay, and negligence penalties, and forfeits the right to any refund as a result of the federal adjustment.
- After filing an amended North Carolina return as a result of filing an amended federal return, S.B. 99 modifies the limitations period for the Department of Revenue to assess any additional tax due. North Carolina income tax may be assessed within:
  - One year after the taxpayer filed the amended return.
  - Three years after the taxpayer's original return was filed or due, whichever is later.
  - Three years after the date the taxpayer filed the amended federal return if no state return was filed.

Insights

- S.B. 99 contains a number of other North Carolina income tax changes, as well as modifications to sales and use tax definitions (and subjecting to sales and use tax repair, maintenance, and installation services to tangible personal property). Taxpayers should evaluate the impact of S.B. 99 to them and the resulting impact on their North Carolina tax positions.
- While technically not effective until July 1, 2018 (the start of North Carolina's new fiscal year), S.B. 99 provides needed clarity with respect to how some of the Tax Cuts and Jobs Act amendments, namely IRC sections 965 and 951A, will be addressed by North Carolina.
- Taxpayers affected by North Carolina's corporate income tax changes enacted by S.B. 99 should consult with their financial statement auditor and tax advisor to evaluate and determine the potential financial statement implications under ASC 740, including the impact on current and deferred taxes, uncertain tax benefits, and disclosures.