

# 2004

## North Carolina S Corporation Tax Return Instructions

### Important Form and Legislative Changes for 2004

#### 1. Closing Franchise Tax Loopholes and Limiting Application of Law to Avoid Unintended Results

G.S. 105-114.1 requires a corporation or an affiliated group of corporations that own fifty percent (50%) or more of the capital interest in a Limited Liability Company (LLC) to include a percentage of the LLC's net assets in the calculation of the corporation's three franchise tax bases. (For additional information, see page 8 and the "2004 Tax Law Changes" available from the Department's website.)

#### 2. Adjustment for Additional First-Year Depreciation

G.S. 105-130.5(a)(15) requires a corporation to add to its federal taxable income 70% of the amount of additional first-year depreciation deducted on its federal return as a result of the federal Job Creation and Worker Assistance Act of 2002 as amended by the Jobs and Growth Tax Relief Act of 2003. (For additional information, see page 8.)

#### 3. Changes to Article 3A Tax Incentives for New and Expanding Businesses and New Article 3F Research and Development Tax Credit

Several changes were made to Article 3A tax incentives that affect the 2004 tax return. These changes include: (1) the addition of a new subdivision defining an eligible major industry, (2) the addition of clarifying rules with respect to providing health insurance for employees and for claiming a tax credit if the taxpayer has an overdue tax debt, and (3) the modification of the determination of the number of new jobs filled during the taxable year. Also, new Article 3F was added to provide a research and development tax credit that is available to more taxpayers than the research and development tax credit under Article 3A. (For detailed information concerning these changes, see the "2004 Tax Law Changes" available from the Department's website. Detailed instructions for completing Form NC-478 and the NC-478A-I series are also available on the Department's website.)

## General Information

**The information contained in this booklet is to be used as a guide in the preparation of the North Carolina S Corporation tax return and is not intended to cover all provisions of the law.**

### **Corporations Required to File**

Every S corporation doing business in North Carolina and every inactive S corporation chartered or domesticated here must file an annual franchise and income tax return using the name reflected on the corporate charter if incorporated in this State, or on the certificate of authority if incorporated outside this State. A franchise tax is imposed on corporations for the privilege of doing business in this State even though the activities are exempt from income tax under P.L. 86-272. For a corporation that is subject to both income tax and franchise tax, its apportionment factor is the same for both taxes. For a corporation that is subject to franchise tax but not income tax, its apportionment factor for computing the amount of franchise tax due is the same factor that would be used if its activities that are protected by P.L. 86-272 were subject to income tax in this State. **Important. Telephone companies previously subject to the gross receipts franchise tax under G.S.105-120 are now subject to general business franchise tax under G.S.105-122.**

### **New S Corporations**

A new S corporation (newly incorporated, newly domesticated out-of-state corporation, or other corporation commencing business in the State) is required to file a tax return with this Department within seventy-five (75) days following the close of its first income year of twelve (12) months or less. The taxable year for a new corporation in this State is presumed to end the calendar month preceding the month of incorporation unless otherwise established by the filing of the required return indicating the taxable year adopted. In no case may the first taxable year exceed 12 months unless it is clearly shown that the corporation has adopted a method of accounting using the 52-53 week reporting period. A tax return is due annually so long as the corporation remains incorporated, domesticated, or continues to do business in this State.

### **Election to be S Corporation**

There is no separate S election for North Carolina income tax purposes. There is no provision to elect a different filing method for State income tax purposes.

### **Termination of S Election**

The S corporation election will terminate for North Carolina purposes at the same time and for the same taxable period the termination is effective for federal tax purposes.

### **Tax Rates**

The franchise tax rate is \$1.50 per \$1,000.00 of capital stock, surplus and undivided profits or other alternative tax base. The minimum franchise tax is \$35.00 with no maximum except for qualified holding companies. The corporate income tax rate for composite filers is based on the current individual income tax rates for single filers.

### **Extensions**

An extension of time to file the franchise and income tax return may be granted for seven (7) months if the extension application is received timely. Without a valid extension, a return filed after the statutory due date will be delinquent and subject to interest and all applicable penalties provided by law. **To receive an extension, taxpayers must file Form CD-419, Application for Extension, by the original due date of the return.**

**A personalized Form CD-419 can be obtained from the Department's website.** The personalized version of Form CD-419 prints personalized data on the application that allows for faster processing. The Department encourages the use of the personalized version of Form CD-419.

**A properly filed federal extension does not constitute a North Carolina extension.**

### **Estimated Income Tax**

Estimated income tax payments are not required on behalf of nonresident shareholders filing a composite tax return; however, if the S corporation makes any prepayments of income tax for nonresidents, the S corporation must claim these prepayments on Schedule B, Line 27b.

### **When and Where to File**

The S corporation tax return is due on the 15th day of the third month following the close of the income year. **Mail returns to:**

**North Carolina Department of Revenue,  
P.O. Box 25000, Raleigh, NC, 27640-0530**

## Computer Generated Substitute Forms

A corporation may file its North Carolina Franchise and Corporate Income tax return on computer generated tax forms approved by the Department. The Department publishes on our website a list of software developers who have received approval. Returns that can not be processed by our imaging and scanning equipment **will be returned to the taxpayer** with instructions to file on an acceptable form.

## Where to Get Forms

In an effort to save the cost of printing and mailing tax booklets, the Department no longer mails tax forms to taxpayers. North Carolina franchise and corporate income tax forms are available from the Department or by going to the Department's website and clicking on "**Tax Forms**". The website offers forms that can be downloaded or filled in on-line and printed. **Forms can also be obtained by calling the Department's toll free forms request line at 1-877-252-3052.**

## Specific Instructions for Filing Form CD-401S

### Period Covered

File the 2004 return for calendar year 2004 and fiscal years that begin in 2004. You must use the same taxable period on your North Carolina return as on your federal return.

**Note:** The 2004 Form CD-401S may also be used if:

- The corporation has a tax year of less than 12 months that **begins in 2004. If the corporation's tax year is less than 12 months, fill in the appropriate circle at the top of the form.**
- The 2005 Form CD-401S is not available at the time the corporation is required to file its return.

**Important.** Returns submitted to the Department that do not meet the specified criteria **will be returned to the taxpayer** with instructions to refile the return on an acceptable form.

### Demographic and Other Taxpayer Information

**Name, Address, and Identification Numbers.** Print or type the corporation's true legal name (as set forth in the corporate charter), address, federal identification number, and North Carolina Secretary of State number on the appropriate lines. Include in this section the corporation's primary NAICS code as determined by the North Carolina Employment Security Commission. *(For further information regarding the NAICS code, see the North American Industry Classification System as published by the Federal Office of Management and Budget.)*

**If a change in address occurs after the return is filed, use Form NC-AC, Business Address Correction, to notify the Department of the new address.**

**Gross Receipts/Sales and Total Assets.** Enter the corporation's gross receipts or sales from all business operations for the tax year. Also enter the corporation's total assets **(as determined by the accounting method regularly used in keeping the corporation's books and records)** at the end of the tax year.

**Initial Return.** If this is the corporation's first return in North Carolina, fill in the appropriate circle.

**Final Return.** If the corporation ceases to exist or leaves North Carolina during the tax year, fill in the appropriate circle. Since franchise taxes are paid in advance or at the beginning of the income year, corporations are not subject to franchise tax after the end of the income year in which articles of dissolution or withdrawal are filed with the Secretary of State unless they engage in business activities not reasonably incidental to winding up their affairs. Although the final income tax return must be filed on a combination franchise and income tax return form, the schedules relating to franchise tax should

be disregarded. This applies, however, only to those corporations officially filing articles of dissolution or withdrawal with the Secretary of State of North Carolina.

**Amended Return.** If filing an amended return, fill in the appropriate circle. A complete explanation as to the reason(s) for filing an amended return, including specific schedule and line number references, must be included on Schedule J of the return. If any change is made to corporate net income by the Internal Revenue Service, taxpayers are required to file an amended North Carolina return within two (2) years after being notified of the correction or final determination. A penalty is imposed for failure to comply with this filing requirement. **Corporations filing amended returns with additional tax due should use Form CD-VX.** *(For more information, see page 7).*

**Limited Liability Companies.** If the taxpayer is a limited liability company that is taxed as a corporation, fill in the appropriate circle.

**CD-479 (Annual Report).** All domestic corporations and foreign corporations authorized to transact business in North Carolina except for insurance companies, limited liability companies, nonprofit corporations, professional corporations, and professional associations must, on an annual basis, file an annual report and remit a twenty dollar (\$20.00) fee. **Taxpayers have the option of either filing the annual report in paper form with the Department of Revenue or in electronic form on-line with the Secretary of State.**

If the corporation elects to file the annual report in paper form with the Department of Revenue, Form CD-479 must be completed in its entirety and placed on **the front page** of the completed tax return. **The circle labeled "CD-479 is attached" located at the top of the tax return must also be filled in.** The \$20.00 fee must be included in the computation of the corporation's income tax due only if the corporation elects to file the report with the Department of Revenue. *(For line-by-line instructions, see page 6).* **Form CD-479 can be obtained from the Department's website or by calling the Department's form request line.**

If the corporation elects to file the annual report in an electronic format on-line with the Secretary of State, go to the Secretary of State's website, [www.sosnc.com](http://www.sosnc.com) for details. **The \$20.00 fee must be paid on-line using one of the payment options offered by the Secretary of State. The Department strongly encourages taxpayers to file the annual report electronically with the Secretary of State.**

**NC-478.** Corporations claiming a credit limited by statute to 50% of tax must complete Form NC-478, Summary of Tax Credits Limited to 50% of Tax, and place it on the front of the completed Form CD-401S. **If the corporation has attached Form NC-478 to Form CD-401S, fill in the appropriate circle.**

**Qualified Subchapter S Subsidiaries (QSSS).** For corporate income tax purposes, North Carolina follows the federal classification of entities under the federal check-the-box regulations. If the corporation meets these qualifications, fill in the appropriate circle. **Note. Qualified Subchapter S Subsidiaries must file separate franchise tax returns (See CTAM-97-13).**

**Escheatable (Abandoned or Unclaimed) Property.** Every corporation holding property of North Carolina residents that is unclaimed and abandoned under General Statutes Chapter 116B must certify the holding of the escheatable property on its income tax return by filling in the appropriate circle. For questions about escheatable property, call (919) 508-5979 or write to:

**Escheat Officer, Department of State Treasurer, Albemarle Building,  
325 N. Salisbury Street  
Raleigh, North Carolina 27603**

## Rounding Off to Whole Dollars

Corporations must round the amounts on the return and accompanying schedules to the nearest whole dollar. Taxpayers should drop any amount less than 50 cents and increase any amount of 50 cents or more to the next whole dollar.

## Computation Of Franchise Tax - Schedule A

### Lines 1 through 5 - Tax Bases

Franchise tax is computed by applying the tax rate of \$1.50 per \$1,000.00, **minimum \$35.00**, to the largest of the following three bases:

- (1) Capital stock, surplus, and undivided profits (Schedule C)
- (2) Investment in North Carolina tangible property (Schedule D)
- (3) Appraised value of North Carolina tangible property (Schedule E)

**Inactive Corporations.** A corporation that is inactive and without assets is subject annually to a minimum franchise tax of \$35. A return containing a statement of the status of the corporation is required to be filed. Failure to file this return and pay the minimum tax will result in suspension of the articles of incorporation or certificate of authority. Any corporation that intends to dissolve or withdraw through suspension for nonpayment of franchise tax should indicate its intention in writing to the Department.

**Capital Stock, Surplus, and Undivided Profits.** Enter the amount of capital stock, surplus, and undivided profits from the book balance sheet as of the end of the tax year. Before making this entry, corporations must complete Schedule C of Form CD-401S (See *instructions on page 7.*)

**Qualified Holding Companies.** Franchise tax payable by a qualified holding company on its capital stock and surplus tax base is limited to an amount not to exceed \$75,000. There is no limitation on the amount of franchise tax payable where the alternative tax bases of investment in tangible property or appraised value of property apply.

**Important.** If the corporation qualifies as a holding company for franchise tax purposes, enter the amount of capital stock on Line 1 and fill in the "Holding Company Exception" circle.

**Investment in North Carolina Tangible Property.** Enter the amount of actual investment in North Carolina tangible property from the book balance sheet as of the end of the tax year. Before making this entry, corporations must complete Schedule D of Form CD-401S (See *instructions on page 7.*)

**Appraised Value of North Carolina Tangible Property.** Multiply the appraised ad valorem tax value of all tangible property located in N.C. by 55%. Before making this entry, corporations must complete Schedule E of Form CD-401S (See *instructions on page 8.*)

### Line 6a - Application for Franchise Tax Extension

If the corporation filed an application for franchise tax extension, Form CD-419, enter the amount of **franchise tax paid** with the extension on Line 6a. (See *Form CD-419, Line 9.*)

### Line 6b - Tax Credits

**To claim a franchise tax credit on Line 6b, corporations must complete Form CD-425, Corporate Tax Credit Summary, and file it with the tax return.** Taxpayers claiming a credit limited by statute to 50% of tax must also complete Form NC-478, Summary of Tax Credits Limited to 50% of Tax, and place it on the front of the completed tax return. **Forms for these credits, as well as the CD-425 and NC-478, are available from the Department's website.**

The following are some of the more utilized franchise tax credits for corporations:

- Machinery & Equipment Investment Tax Credit
- Job Creation Tax Credit
- Research and Development Tax Credit
- Worker Training Tax Credit
- Central Office or Aircraft Facility Property Tax Credit
- Investing in Renewable Energy Property Tax Credit
- Credit for Supervisory Fees (savings and loan associations only)
- Credit for the Rehabilitation of Historic Structures
- Credit for Use of North Carolina Ports
- Credit for Real Property Donated for Conservation Purposes

(For specific information regarding each of these credits, refer to the *Franchise Tax and Corporate Income Tax Rules and Bulletins.*)

**Mergers.** Since franchise tax is prepaid, a special computation is sometimes required to prevent a duplication of tax when two or more corporations with different income years merge or otherwise transfer the entire assets from one corporation to the other. (For specific information and the procedure for making this computation, refer to the *Franchise Tax and Corporate Income Tax Rules and Bulletins.*)

### Lines 7 and 8 - Franchise Tax Due / Overpaid

Subtract Lines 6a and 6b from Line 5. If the total of Line 6a plus 6b is less than Line 5, **additional franchise tax is due.** Enter the amount of additional tax due on Line 7 and on Page 2, Line 31. If the total of 6a plus 6b is more than Line 5, **franchise tax is overpaid.** Enter the amount of overpayment on Line 8 and on Page 2, Line 31. **Fill in the circle located next to Line 31 to indicate the amount is overpaid.**

**(Overpaid franchise tax can offset underpaid income tax in the same tax year and vice versa. See "Tax Due or Overpayment" section, on page 6 for line-by-line instructions.)**

## Computation of Income Tax - Schedule B

### Line 9 - Shareholders' Shares of Corporation Income (Loss)

Enter the total amount of income or loss for the S corporation on Line 9. Before making this entry, corporations must complete Schedules G and H of Form CD-401S. (See instructions on page 8.) **If the amount on Line 9 is negative, enter the amount and fill in the circle located next to Line 9 to indicate the amount is negative. Do not use brackets or other symbols to indicate a negative number.**

### Line 10 - Adjustments to Federal Taxable Income

Taxpayers must make certain adjustment to federal taxable income in arriving at North Carolina taxable income. Before making this entry, corporations must complete Schedule I of Form CD-401S. (See *instructions on page 8.*) **If the amount on Line 10 is negative, enter the amount and fill in the circle located next to Line 10 to indicate the amount is negative.**

### Line 12 - Nonapportionable Income

When a corporation has income from sources within North Carolina as well as sources outside North Carolina a determination of apportionable and nonapportionable income must be made. If the corporation's business is conducted entirely within North Carolina, enter zero on Line 12. If the business is both within and outside of North Carolina, enter the total amount of nonapportionable income on Line 12. Before making this entry, corporations must complete Schedule N of Form CD-401S. (See *instructions on page 9.*) **If the amount on Line 12 is negative, enter the amount and fill in the circle located next to Line 12 to indicate the amount is negative.**

### Line 13 - Apportionable Income

Effective for taxable years beginning on or after January 1, 2002, the definition of "business income" has been amended to include all income that is apportionable under the U.S. Constitution. Income is apportioned to North Carolina and to other states based on the apportionment factor. **If the amount on Line 13 is negative, enter the amount and fill in the circle located next to Line 13 to indicate the amount is negative.**

### Line 14 - Apportionment Factor

Enter the apportionment factor percentage as calculated from Schedule O of Form CD-401S. **The apportionment factor must be calculated four places to the right of the decimal.** (See *instructions on page 9.*)

**Line 16 - Nonapportionable Income Allocated to N.C.**

Enter on Line 16 the amount of nonapportionable income allocated directly to this State. Before making this entry, corporations must complete Schedule N of Form CD-401S. (See instructions on page 9.) **If the amount on Line 16 is negative, enter the amount and fill in the circle located next to Line 16 to indicate the amount is negative.**

**Lines 20 through 24 - Composite Tax Returns**

Lines 20-24 are to be completed only by an S corporation filing a composite income tax return on behalf of its nonresident shareholders. A composite return is an income tax return that combines and reports the income and tax due of participating nonresident shareholders. A nonresident individual shareholder is not required to file a North Carolina individual income tax return, Form D-400, if the shareholder's only income in North Carolina is reported by the S corporation. If the nonresident shareholder is a trust or another S corporation, the entity must file a separate North Carolina tax return.

To determine tax due for nonresidents filing composite, use the Tax Rate Schedule found on page 8 of Form CD-401S. North Carolina income tax must be separately computed for each nonresident shareholder filing composite. The S corporation must total the separate income tax for each participating nonresident shareholder and enter the total on Line 22.

**Line 21 - Separately Stated Items of Income Attributable to Nonresidents Filing Composite**

Special rules apply for gain from the sale, exchange, or disposition of Internal Revenue Section 1231 property on which a Code Section 179 expense deduction was previously claimed. For federal purposes, the gain is no longer included at the entity level but instead is passed through separately to the individual shareholders. As a result, the gain is included in federal taxable income on the shareholder's income tax return but is not included as part of the shareholder's share of the corporation's income. (See Schedule K, Line 5.)

S corporations must identify each nonresident shareholder's share of separately stated income items and enter the amount on Schedule K, Line 12, and Schedule K-1, Line 7.

**(Note. Losses attributed to the sale of Section 1231 property are not deductible in the calculation of North Carolina income tax for nonresident shareholders filing composite. Taxpayers wishing to deduct their pro rata share of these losses must do so by filing a North Carolina income tax return.)**

**Line 23 - Income Tax Credits Attributable to Nonresidents Filing Composite**

In order for nonresidents filing composite to claim income tax credits, the S corporation must complete Form CD-425, Corporate Tax Credit Summary, and file it with the completed tax return. **The S corporation must include only the amount of income tax credits allocated to nonresident shareholders on whose behalf a composite return is filed.** In order for composite filers to claim an income tax credit limited by statute to 50% of tax, the S corporation must also complete Form NC-478, Summary of Tax Credits Limited to 50% of Tax, and place it on the front of the completed tax return. **Forms for these credits, as well as the CD-425 and the NC-478, are available from the Department's website.**

The following are some of the more utilized income tax credits for corporations:

- Machinery & Equipment Investment Tax Credit
- Job Creation Tax Credit
- Research and Development Tax Credit
- Worker Training Tax Credit

- Central Office or Aircraft Facility Property Tax Credit
- Investing in Renewable Energy Property Tax Credit
- Credit for Supervisory Fees (savings and loan associations only)
- Credit for the Rehabilitation of Historic Structures
- Credit for Use of North Carolina Ports
- Credit for Real Property Donated for Conservation Purposes

**Important: If there is more than one nonresident shareholder filing composite and all shareholders are not subject to the same individual income tax rate, complete the "Nonresident Shareholder Filing Composite Income Tax Credit Worksheet" below for each nonresident shareholder.**

<b>Nonresident Shareholder Filing Composite Income Tax Credit Adjustment Worksheet</b>	
<i>(Complete this worksheet <b>only</b> if all nonresident shareholders filing composite are not subject to the same individual income tax rate)</i>	
<p><b>1. Enter shareholder's share of income tax credits subject to G.S. 105-130.5(a)(10) adjustment</b> (From Form CD-425, Part 4, Line 24) .....</p>	<p>_____</p>
<p><b>2. Enter shareholder's individual income tax rate used to calculate N.C. income tax</b> (See Form CD-401S, Schedule B, Line 22) .....</p>	<p>_____</p>
<p><b>3. Shareholder's share of S corporation adjustment</b> Multiply Line 1 by Line 2 .....</p>	<p>_____</p>
<p><b>4. S Corporation Adjustment</b> Total the amount of Line 3 for all nonresident shareholders filing composite, enter here and on Form CD-425, Part 4, Line 25b .....</p>	<p>_____</p>

**Line 25 - Annual Report Fee**

If the corporation elects to pay the annual report fee in paper format with the income tax return, enter \$20.00 on Line 25; otherwise, enter zero. (For detailed information on the annual report fee, see the instructions on page 4, CD-479, Annual Report.)

**Line 27 - Tax Payments**

- a. Application for Extension.** Taxpayers filing a Form CD-419 enter the amount of income tax paid on Line 10 of the CD-419 on Line 27a.
- b. 2004 Estimated Tax.** Enter any estimated income tax payments for 2004 (including any portion of the 2003 overpayment that was applied to the 2004 estimated income tax and any payment remitted on behalf of nonresident shareholders) on Line 27b.
- c. Partnerships** - If the corporation is a nonresident partner enter the amount of tax paid to North Carolina on behalf of the corporate partner on Line 27c.
- d. Nonresident Withholding** - Enter the amount of tax withheld from a nonresident corporation for nonwage compensation during the taxable year on Line 27d.

**Lines 29 and 30 - Income Tax Due / Overpaid**

Subtract Line 28 from Line 26. If Line 28 is less than Line 26 **additional income tax is due**. Enter the amount of additional tax on Line 29 and on Line 32. If Line 28 is more than Line 26, **income tax is overpaid**. Enter the amount of overpayment on Line 30 and on Line 32. **Fill in the circle located next to Line 32 to indicate the amount is overpaid.**

**(Overpaid franchise tax can offset underpaid income tax in the same tax year and vice versa. See "Tax Due or Overpayment" below for line-by-line instructions.)**

### Lines 31 through 33 - Tax Due or Overpayment

A corporation that overpays its franchise or income tax may elect to have its refund applied to an underpaid franchise or income tax liability in the same tax year. The netting of an overpaid tax to an underpaid liability is calculated by adding or subtracting Lines 31 and 32.

### Line 34 - Penalties and Interest

**Interest.** Interest at the rate established by G. S. 105-241.1 is charged on taxes paid late even if an extension of time to file is granted. The interest rate on underpayments is the same as the interest rate on overpayments. The rate is established semiannually by the Secretary of Revenue and is listed on the Department's website.

**Failure to file penalty.** Returns filed after the due date are subject to a penalty of 5% of the tax for each month, or part of a month, the return is late (minimum \$5.00; maximum 25% of the additional tax).

**Failure to pay penalty.** Returns filed after the statutory due date without a valid extension are subject to a late payment penalty of 10% of the unpaid tax. If the corporation has an extension of time for filing its return, the 10% penalty will apply on the remaining balance due. The minimum penalty is \$5.00.

**Collection Assistance Fee.** Any tax, penalty, and interest not paid within 90 days after a final notice of assessment has been mailed is subject to a 20% collection assistance fee. The fee will not apply to taxpayers that make payments under an installment agreement that became effective within 90 days after the final notice was mailed.

### Line 35 - Total Due

Add Lines 33 and 34, and enter the total on Line 35, but not less than zero. **This is the total tax, penalties, and interest due.** Make your check or money order payable to the **North Carolina Department of Revenue.** Mail the return, any balance due, and a personalized payment voucher, Form CD-V, to:

**North Carolina Department of Revenue,  
P.O. Box 25000, Raleigh, NC 27640-0530**

**Important. The Department will not accept a check or money order unless it is drawn on a U.S. (domestic) bank and the funds are payable in U.S. dollars.**

**Form CD-V (Corporate Payment Voucher).** Form CD-V is a personalized voucher that a corporation should send with any balance due. This voucher allows the Department to process payments more accurately and efficiently with fewer errors. To generate a personalized voucher, go to the Department's website and click on "**Tax Forms**".

**Form CD-VX (Amended Corporate Payment Voucher).** If filing an amended CD-401S, corporations owing additional tax should use Form CD-VX, amended corporate tax payment voucher. Form CD-VX allows the Department to process amended payments more accurately and efficiently with fewer errors. To generate the amended personalized payment voucher, go to the Department's website and click on "**Tax Forms**".

### Line 36 - Overpayment

If the sum of Lines 33 and 34 is less than zero, the corporation has overpaid its tax. Enter the amount of overpayment on Line 36.

### Line 37 - Estimated Income Tax

A corporation may elect to apply part or all of the overpayment shown on Line 36 to its estimated income tax for the following year by entering the amount to be applied on Line 37. **This election cannot be changed after the return is filed.**

### Line 38 - Amount to be Refunded

Enter the amount of overpayment to be refunded on Line 38. The amount to be refunded cannot exceed Line 36 minus Line 37.

### Signature and Verification

An authorized officer must sign and date the completed tax form and enter his or her corporate title. **A phone number for the corporation, including area code, is also requested.** If a paid preparer is used, the preparer must also sign and date the return and enter the firm's federal employer ID number, social security number, or PTIN as assigned by the IRS.

### Capital Stock, Surplus, and Undivided Profits - Schedule C

In addition to the items listed on the schedule, include stock subscribed, deferred taxes, and all other surplus, reserves, deferred credits, and inventory valuation reserves, including amounts deferred as result of a LIFO valuation method (LIFO reserves), and liabilities except: (a) reserve for depreciation permitted for income tax purposes; (b) accrued taxes; (c) dividends declared; (d) definite and accrued legal liabilities (accounts, notes, mortgages payable, etc.). Deferred income resulting from customer advances for goods or services may be excluded from this base provided: (1) there exists a definite legal liability to render the service or deliver the goods; (2) no part of the advances has been reported or is reportable for income tax purposes; and (3) all related costs and expenses are reflected in the balance sheet as assets. Deferred income net of related deferred income taxes arising from the usual installment sale is not deductible because the corresponding liability would have been discharged at the time of delivery.

Indebtedness owed to a parent, subsidiary, or affiliated corporation is considered a part of the debtor corporation's capital and must be added to the debtor corporation's capital stock, surplus, and undivided profits. If the creditor corporation has borrowed a part of its capital from outside sources (i.e., sources other than a parent, subsidiary, or affiliated corporation), the debtor corporation may exclude a proportionate part of the debt determined on the basis of the ratio of the creditor corporation's capital borrowed from outside sources to the creditor corporation's total assets.

The creditor corporation, if subject to the tax, can deduct from its capital stock, surplus, and undivided profits the amount of indebtedness owed to it by a parent, subsidiary, or affiliated corporation to the extent that the indebtedness has been added by the debtor corporation on a return filed with this State. **The exclusion permitted the debtor corporation and the deduction permitted the creditor corporation are applicable only to indebtedness owed to or due from a parent, subsidiary, or affiliated corporation.**

**Cash Basis Corporations.** Corporations using the cash basis method of accounting for income tax purposes cannot compute the capital stock, surplus, and undivided profits base by this method. Assets and liabilities must be accrued and reported for franchise tax purposes.

### Investment in North Carolina Tangible Property - Schedule D

Include all tangible assets located in North Carolina at book value (original purchase price less reserve for depreciation permitted for income tax purposes.) **LIFO valuation is not permitted for inventories.**

A deduction from the tangible property base is allowed for indebtedness incurred and existing by virtue of the purchase or permanent improvement of real estate located in North Carolina. The deductible amount cannot exceed the book value (cost less depreciation) of the real estate acquired or improvements made. Debts incurred in the purchase of personal property are not deductible even though the funds borrowed are secured by a lien against real estate. Indebtedness owed to a parent, subsidiary, or affiliated corporation constitutes a part of the debtor corporation's capital and, therefore, cannot be deducted from the tangible property tax base (except to the extent explained below) even though the indebtedness was incurred in the purchase or permanent improvement of real estate. The extent to which the indebtedness can be deducted is the amount of the total debt excluded by the debtor corporation from its capital stock, surplus, and undivided profits base by application of the creditor corporation's borrowed capital ratio.

**Air or Water Pollution Abatement and Recycling Resource Recovering Facilities.** A corporation may deduct from Schedule C and Schedule D the cost of any air cleaning device, sewage or waste treatment plant, and pollution abatement equipment purchased or constructed in this State. The cost of constructing a facility for recycling solid waste or for reducing hazardous waste may also be deducted from these bases. **A deduction is allowed only upon certification from the Department of Environment and Natural Resources.**

### Appraised Value of North Carolina Tangible Property - Schedule E

Enter 55% of the appraised value, not book value, of all property listed for county ad valorem tax in North Carolina. This value includes the appraised value of all vehicles for which the county tax assessor has issued a billing during the income tax year. **Values are to be determined as of the dates specified on Schedule E of the return.**

### Corporate Member of a Limited Liability Company (LLC)

A limited liability company's income, assets, liabilities, or equity is generally not attributed to a corporation that is a member of the LLC. However, if the corporation or an affiliated group of corporations owns fifty percent (50%) or more of the capital interests in a LLC, the corporation must include a percentage of the LLC's net assets in the calculation of the corporation's three franchise tax bases. **For example:** A partnership owns 100% of the capital interests of an LLC. Corporation A is a 50% owner of the partnership. Corporation A constructively owns 50% of the capital interest in the LLC.

If all members of the affiliated group are doing business in NC, then each member includes the percentage of the LLC's assets equal to the member's percentage ownership in the LLC. If some of the members of the group are not doing business in NC, then the percentage of the LLC's assets owned by the group are allocated among the members that are doing business in NC. The percentage attributed to each member doing business in NC is determined by multiplying the percentage of the LLC owned by the entire group by a fraction. The numerator of the fraction is the member's percentage ownership of the LLC and the denominator is the total percentage of the LLC owned by all members doing business in NC.

**For example:** An affiliated group of corporations owns 100% of the capital interests in an LLC. The group consists of three corporations. Corporation A is doing business in NC and owns 50% of the LLC. Corporation B is doing business in NC and owns 10% of the LLC. Corporation C is not doing business in NC and owns 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:

- Corporation A  $100\% \times 50\% \div (50\% + 10\%) = 83.33\%$
- Corporation B  $100\% \times 10\% \div (50\% + 10\%) = 16.67\%$

**Important.** If a corporation is required to include a percentage of the LLC's assets in the calculation of its franchise tax bases, the corporation may exclude its investment in the LLC from the computation of the capital stock base. **Also,** if the total book value of the LLC's assets never exceed \$150,000 during the taxable year, no attribution is required.

**Note.** For franchise taxes paid on or after January 1, 2003 through December 31, 2004, prior law required a corporation to include a percentage of an LLC's assets in the computation of its franchise tax if the corporation and its related members together owned indirectly seventy percent (70%) or more of the LLC's assets. A related member included a shareholder of the corporation. The law was changed so that a corporation does not include a shareholder's ownership interest in the LLC in determining whether the corporation owned 70% of the LLC's assets nor in the apportionment of the LLC's assets among the affiliated group of corporations. A taxpayer that included a percentage of an LLC's assets in the computation of its franchise tax based upon a shareholder's ownership of the LLC's assets may be due a refund. For detailed information, see the "2004 Tax Law Changes" available from the Department's website.

## Other Information - Schedule F

**MUST BE COMPLETED BY ALL TAXPAYERS**

### Ordinary Income (Loss) From Trade or Business - Schedule G

The computation of net income from trade or business activities follows the determination of ordinary income as defined by the Internal Revenue Code, effective May 1, 2004. S corporations must transfer the information from federal Form 1120S, U.S. Income Tax Return for an S Corporation (Lines 1 through 21), to Schedule G, or attach a copy of the federal form along with all supporting schedules.

**Attach federal Form 1120S along with all supporting schedules only if the North Carolina return is not completed in its entirety.**

### Computation of Income (Loss) - Schedule H

- Line 1** Enter the ordinary business income(loss) as taken from federal Form 1120S, Line 21 or from Schedule G, Line 21.
- Lines 2-10** Add income or deduct losses on Lines 2-10 that are directly passed to the shareholders as shown on federal Schedule K, Lines 2-9.
- Line 11** Total of Lines 1-10; enter on Schedule B, Line 9.

### Adjustments to Income (Loss) - Schedule I

Taxpayers must make certain adjustments to federal taxable income in arriving at North Carolina taxable income. Schedule I provides some of the adjustments required by statute but is not an all-inclusive list. **The instructions for filing C corporation tax returns, available from the Department's website, list all the provisions of G.S. 105-130.5.**

**Adjustment for Additional First-Year Depreciation.** The federal Job Creation and Worker Assistance Act of 2002 allowed a 30% additional first-year depreciation deduction on the federal return for certain assets acquired after September 10, 2001 and before September 11, 2004, and placed in service before January 1, 2005. With the passage of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, the bonus depreciation rules were amended to increase the first-year depreciation deduction from 30% to 50% for property placed in service after May 5, 2003. **North Carolina law did not adopt the additional first-year depreciation provision.**

For taxable year 2004, corporations are required to add to federal taxable income an amount equal to 70% of the additional first-year depreciation deducted on the federal return. (See Schedule I, Line 1f.) No addback is required for any taxable year beginning on or after January 1, 2005. This adjustment does not result in a difference in basis of the affected assets for State and federal income tax purposes.

Any amount of additional first-year depreciation added to federal taxable income on the 2002, 2003, or 2004 State return may be deducted in five equal installments over the first five taxable years beginning with the tax return for taxable year 2005.

**In situations where differences exist between corporate income tax law and individual income tax law relative to the tax liability of any taxpayer, the requirements of the levying statute, i.e. individual income tax, will normally prevail over the law requiring informational reporting. Deductions which are subject to personal limitations such as Internal Revenue Code Section 179, charitable contributions, and net economic losses are not deductible in the calculation of North Carolina Taxable Income. Taxpayers wishing to deduct their pro rata share of these flow-through items must do so by filing a North Carolina income tax return.**

### Shareholders' Share of Income, Adjustments, and Credits - Schedule K

This schedule is provided primarily as a worksheet to the S corporation to summarize all the shareholders' shares of income, North Carolina adjustments, and North Carolina tax credits, and to show the amount

of these items that are apportioned or allocated to nonresident shareholders. The name, address, and percentage of ownership of each shareholder must be listed on Schedule K. A North Carolina resident is required to report its full share of corporate income or loss. A nonresident shareholder, however, is only required to report to North Carolina its share of apportioned and allocated income or loss.

The S corporation must give each shareholder a copy of Form NC K-1. The NC K-1 is the form used to report each shareholder's share of these items. The cumulative total of a given line on all of the shareholders' NC K-1s must equal the amount that the corporation reports in the Shareholders' Total column of Schedule K. A nonresident shareholder filing a composite income tax return must be provided with its share of net tax paid on its behalf by the S corporation. **(For additional instructions on Form NC K-1, see page 10.)**

## Balance Sheet - Schedule L and Schedule M-1

Complete these schedules only if you do not attach a copy of federal Schedule L and Schedule M-1, along with all supporting schedules.

## Analysis of N.C. Accumulated Adjustments Account, N.C. AAA - Schedule M-2

All corporations must maintain an "accumulated adjustments account" (AAA) for federal and state purposes. The N.C. accumulated adjustments account, N.C. AAA, may be different than the federal AAA for S corporations that were in existence prior to 1989 and for S corporations making adjustments under G.S. 105-130.5. The computation of the N.C. AAA and N.C. other adjustments account is made using the same procedures as the federal computation applying the North Carolina amounts. **(See instructions for federal Form 1120S and IRC §1368.)**

**N.C. Other Adjustments Account.** The N.C. other adjustments account, N.C. OAA, is increased by North Carolina income not taxed and reduced by nondeductible expenses related to North Carolina income not taxed.

## Nonapportionable Income - Schedule N

Nonapportionable income is income that cannot be apportioned because of the U.S. Constitution. Nonapportionable income is not subject to apportionment, but is allocated.

In general, all transactions and activities of a taxpayer that are dependent upon, or contribute to the operations of the taxpayer's economic enterprise as a whole, constitute the taxpayer's trade or business. Income from these type of transactions and activities are operational income and therefore apportionable.

Nonapportionable income includes rents and royalties from real or tangible personal property, capital gains, interest, dividends, and patent and copyright royalties, to the extent they are not dependent upon, or contribute to, the operations of the taxpayer's economic enterprise as a whole. Nonapportionable income must be reduced by the related expenses incurred to generate the nonapportionable income. **(The instructions for filing a C corporation tax return, available from the Department's website, include a worksheet for the computation of expenses attributable to income not taxed.)**

## Computation of Apportionment Factor - Schedule O

All corporations, domestic or foreign, doing business in North Carolina must complete Schedule O in order to compute North Carolina taxable income.

## Domestic Corporations - Part 1

Corporations not apportioning franchise or income outside of N.C. must enter 100% in the area provided. Foreign corporations doing business in N.C. but not taxable in another state must also enter 100% for its apportionment factor.

## Multistate Corporations - Part 2

A corporation having income from business activities that is taxable both within and without North Carolina is required to apportion its State net income or net loss. For purposes of allocation and apportionment, a corporation is taxable in another state if (i) the corporation's business activity in that state subjects it to a net income tax or a tax measured by net income, or (ii) that state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless of whether that state exercises its jurisdiction. For purposes of this section, 'business activity' includes any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code § 381.

All business income of corporations other than public utilities and excluded corporations must be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. If the sales factor does not exist, the denominator is the number of existing factors. If a property or a payroll factor does not exist, the denominator is the number of existing factors plus one. **Calculate the apportionment factor to four places to the right of the decimal.**

### Lines 1 through 8 - Property Factor

The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this State during the income year and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the income year. The numerator includes not only inventories actually located in North Carolina but also inventories in transit with a North Carolina destination.

Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net rent paid during the current income year. Net annual rent is the annual rent paid by the corporation less any annual rent received by the corporation from subrentals except that subrentals are not deductible when they constitute apportionable income. Any property under construction or any property not actually used or operated in the corporation's business during the income year and any property the income from which constitutes nonapportionable income are excluded in the computation of the property factor.

The average value of property is determined by averaging the values at the beginning and end of the income year, but in all cases the Secretary may require the averaging of monthly or other periodic values during the income year if required to reflect properly the average value of the corporation's property. A corporation that ceases its operation in this State before the end of its income year for any reason whatsoever must use property values as of the first day of the income year and the last day of its operations in this State in determining the average value of property; however, the Secretary may require the averaging of monthly or other periodic values during the income year.

### Lines 9 through 11 - Payroll Factor

The payroll factor is a fraction, the numerator of which is the total compensation paid in this State during the income year by the corporation and the denominator of which is the total compensation paid everywhere during the income year. All compensation paid to general executive officers and all compensation paid in connection with nonbusiness income shall be excluded in computing the payroll factor. General executive officers include the chairman of the board, president, vice-presidents, secretary, treasurer, comptroller, and any other officer serving in similar capacities.

Compensation is paid in this State if any of the following applies:

- (1) The individual's service is performed entirely within the State; or
- (2) The individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State.
- (3) Some of the service is performed in this State and the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled, is in this State.
- (4) Some of the service is performed in this State and the base of operations or the place from which the service is

directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

**Lines 12 and 13 - Sales Factor**

The sales factor is a fraction, the numerator of which is the total sales of the corporation in this State during the income year, and the denominator of which is the total sales of the corporation everywhere during the income year. Receipts from any casual sale of property, receipts exempt from taxation, and the portion of receipts realized from the sale or maturity of securities or other obligations that represent a return of principal are excluded from both the numerator and the denominator of the sales factor. If a corporation is not taxable in another state on its apportionable income but is taxable in another state only because of nonapportionable income, all sales are treated as having been made in this State.

Sales of tangible personal property are in this State if the property is received in this State by the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed is considered the place at which the goods are received by the purchaser.

Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State constitutes delivery to the purchaser in this State.

Other sales are in this State if any of the following applies:

- (1) The receipts are from real or tangible personal property located in this State.
- (2) The receipts are from intangible property and are received from sources within this State.
- (3) The receipts are from services and the income-producing activities are in this State.

**Special Apportionment Provisions - Parts 3 and 4**

Special apportionment provisions apply to certain types of corporations and excluded corporations. The respective tax statutes should be consulted for specific allocation requirements.

**Excluded Corporations.** Any corporation engaged in business as a building or construction contractor, a securities dealer, a loan company, or a corporation that receives more than fifty percent (50%) of its ordinary gross income from intangible property apportions its business income by using the sales factor alone.

**Contractors.** A multistate building or construction contractor must use a one factor sales (gross receipts) formula to apportion its business income to this State. A building or construction contractor is a business so classified under the North American Industry Classification System.

**Air and Water Transportation.** All business income of an air or water transportation company is apportioned by the ratio of revenue-ton miles in North Carolina to total revenue-ton miles. A revenue-ton mile is one ton of passenger, freight, mail, or other cargo carried one mile; each passenger is deemed to weigh 200 pounds.

**Motor Carriers.** All business income of a motor carrier of property or passengers must be apportioned by multiplying the income by a fraction, the numerator of which is the number of vehicle miles in this State and the denominator of which is the total number of vehicle miles of the company everywhere. The words "vehicle miles" mean miles traveled by vehicles owned or operated by the company hauling property for a charge, carrying passengers for a fare, or traveling on a scheduled route.

<b>Computation of Apportionment Factor for Motor Carriers - Vehicle Miles Factor</b>	
<b>1.</b>	Number of vehicle miles traveled in N.C. ....
<b>2.</b>	Total number of vehicle miles traveled everywhere .....
<b>3.</b>	<b>Percentage of Mileage in N.C. Factor</b> (Divide Line 1 by Line 2; enter amount here and on Schedule O, Part 4) ..... %

**Telephone Companies.** All business income of a telephone company must be apportioned by multiplying the income by a fraction, the numerator of which is gross operating revenues earned in this State plus other revenue items attributed to this State specifically listed in G.S. 105-130.4(n) and the denominator of which is the total gross operating revenue from all business done by the company everywhere less uncollectible revenue. (See worksheet below.)

<b>Computation of Apportionment Factor for Telephone Companies - Gross Operating Revenue Factor</b>	
<b>1. Gross Operating Revenues in North Carolina</b>	
a.	Gross operating revenue from local service in N.C. ....
b.	Gross operating revenue from toll services within N.C. ....
c.	N.C. portion of revenue from interstate toll services .....
d.	Gross operating revenues in N.C. from other services .....
e.	Total gross operating revenues assignable to N.C. (Add Lines 1a - 1d) .....
f.	N.C. uncollectible revenue ..... ( )
g.	Total adjusted gross operating revenues assignable to N.C. (Line 1e minus Line 1f) .....
<b>2. Gross Operating Revenues Everywhere</b>	
a.	Total gross operating revenues .....
b.	Total uncollectible revenue .....
c.	Total adjusted gross revenues everywhere (Line 2a minus 2b) ..... ( )
<b>3.</b>	<b>Gross Operating Revenue Factor</b> (Divide Line 1g by Line 2c; enter amount here and on Schedule O, Part 4) ..... %

**Instructions and Forms for the NC-478 Series**

NC-478, NC-478A-I, NC-478V and the NC-478 Instructions are available from the Department's website, [www.dor.state.nc.us](http://www.dor.state.nc.us).

**Shareholder's Share of North Carolina Income, Adjustments, and Credits - Schedule NC K-1**

Schedule NC K-1 is the form used by the S corporation to report to each shareholder its share of the S corporation's income, adjustments, tax credits, etc. Prepare and give a Schedule NC K-1 to each entity that was a shareholder in the S corporation at any time during 2004. Schedule NC K-1 must be provided to each shareholder on or before the due date of the return. (A Form NC K-1 is available in this booklet. Additional forms are available from the Department's website.)

Shareholders that are **residents of North Carolina** must be provided with the total amount of their proportionate share of the following items:

- 1. North Carolina adjustments to federal taxable income, NC K-1, Lines 2 and 3.
- 2. Shareholder's distributive share of tax credits, NC K-1, Line 4. When reporting the distributive share of tax credits, a list of the amount and type of each tax credit must be provided to the shareholder.
- 3. Any tax withheld from nonwage compensation for personal services in North Carolina by the S corporation, NC K-1, Line 5.

Shareholders that are **nonresidents of North Carolina** must be provided with their share of the same items listed above for North Carolina residents, along with the following items:

- 1. North Carolina income apportioned and allocated for business activities occurring outside of North Carolina, NC K-1, Line 6.
- 2. Shareholder's share of separately stated items of income, NC K-1, Line 7.
- 3. Any North Carolina income tax paid by the S corporation on behalf of the nonresident shareholder, NC K-1, Line 8.