

1998

NORTH CAROLINA CORPORATION FRANCHISE AND INCOME TAX INSTRUCTIONS

Important 1998 Changes

- Reference to the Internal Revenue Code Updated.**

G.S. 105-228.90 (b)(1a) was amended to update the reference to the Internal Revenue Code from January 1997 to September 1, 1998, including any provisions enacted as of that date which become effective on or after that date. (Effective October 2, 1998)
- Economic Loss Carryforward Increased from Five to Fifteen Years**

G.S. 105-130.8 and G.S. 105-130.5(b) was amended to increase the number of years a net economic loss may be carried forward from five to fifteen years. The fifteen year carryforward is effective for tax years beginning on or after January 1, 1999 and applies to losses incurred for tax years beginning on or after January 1, 1993. A loss that is more than five (5) years old may offset no more than fifteen percent (15%) of any taxable income before the remaining portion may be carried forward. For years beginning on or after January 1, 2002, the percentage limitation is repealed.
- Changes to Article 3A Tax Credits under the "Economic Opportunity Act of 1998"**

Several changes were made to the New and Expanding Business Tax Credits as enacted in the 1996 Session of the North Carolina General Assembly. Chapter 105 was amended to add section 105-129.3A authorizing enhanced incentives for a business that locate within a Development Zone. G.S. 105-129.6 was amended to add subsection (a1) providing that a taxpayer must pay the Department of Commerce a fee of seventy-five dollars (\$75.00) when filing an application. For a detailed description of all revisions made to Article 3A of Chapter 105 along with revised computational worksheets, see the North Carolina tax credit forms for the computation of "William S. Lee Quality Jobs and Business Expansion Act".
- Tax Incentives for Recycling Facilities**

Chapter 105 was amended to add Article 3C, "Tax Incentives for Recycling Facilities". This amendment provides tax incentives for the initial construction of "large" recycling facilities of at least \$150,000,000 in new investments, and "major" recycling facilities of at least \$300,000,000 in new investments. (Effective for taxable years beginning on or after January 1, 1998.)
- Changes on Nonresident Withholding from Certain Corporations**

Several changes were made to G.S. 105-163, the withholding statutes, which relate to the withholding of certain payments to foreign corporations. Changes include an increase in the dollar threshold amount for required withholding of nonresidents from six hundred dollars (\$600.00) to one thousand-five hundred dollars (\$1500.00) and amends the definition of a contractor to include "nonresident entities that provide for the performance in this State for compensation of any personal services in connection with a performance, an entertainment, an athletic event, a speech, or the creation of a film, radio, or television program." (Amendments to G.S. 105-163.1(2) are effective retroactive to January 1, 1998.)
- Taxation of Savings and Loan Associations**

G.S. 105-228.22 through G.S. 105-228.27 was recodified to move the provisions concerning taxation of savings and loan institutions from Article 8D to the regular corporate income and franchise tax statutes found in Articles 3 and 4 of Chapter 105 of the North Carolina Revenue Laws. Savings and loan institutions retain the two specific adjustments formerly found under Article 8D (the supervisory fees tax credit and the deduction of interest on deposits with FHLB). Savings and loan institutions formerly filing Form CD-301 must now file Form CD-405. (Effective August 14, 1998)
- Motor Carriers Subject to Franchise Tax**

Due to modifications made to G.S. 20-97 by the 1997 session of the North Carolina General Assembly, motor carriers are no longer exempt from the State franchise tax imposed by G.S. 105-122. Motor carriers formerly filing Form CD-406 must now file Form CD-405 or CD-401S whichever is applicable. (Effective January 1, 1998)

GENERAL INSTRUCTIONS

Tax Rates

The franchise tax rate is \$1.50 per \$1000 of Capital Stock, Surplus, and Undivided Profits or other alternative base described on pages 4 and 5. The minimum franchise tax is \$35.00 with no maximum except for qualified holding companies. The corporate income tax rate is 7.25% of net income attributed to North Carolina.

Corporations Required to File

Every corporation doing business in North Carolina and every inactive corporation chartered or domesticated here must file an annual franchise and income tax return using the name reflected by the corporate charter if incorporated in this State or 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 the income tax under P.L. 86-272 (see definitions page 8). 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 taxes in this State. Corporations which are statutorily exempt and the conditions under which certain other corporations may qualify for exemption are described on page 5.

Check-the-Box Filing Requirements

North Carolina follows the federal treatment for income tax purposes for selection of entities under the federal check-the-box regulations. Qualified Subchapter S Subsidiaries must file separate franchise tax returns. (CTAM-97-13) Limited Liability Companies are not subject to the franchise tax imposed by G. S. 105-122.

Time and Place for Filing

Franchise and income tax returns are due on the 15th day of the third month following the close of the income year. Income tax returns for cooperative or mutual associations are due on or before the 15th day of the ninth month following the close of the income year; however, such corporations, if subject to franchise tax, must file a franchise tax return by the 15th day of the third month following the close of the income year. Returns should be filed with the North Carolina Department of Revenue, P.O. Box 25000, Raleigh, NC, 27640-0500 or at one of the Department's local branch offices.

Payment of Taxes

The corporation's liability for franchise and income tax is payable in full to the North Carolina Department of Revenue at the time the return is due to be filed.

Extension of Filing Date

An extension of time to file the franchise and income tax return may be granted for seven (7) months providing the extension application is received timely. Without a valid extension, a return filed after the statutory due date will be delinquent and subject to all applicable penalties provided by law. **Note: A properly filed federal extension does not constitute a North Carolina extension.**

Penalties

A franchise and income tax return filed after the statutory due date or after the approved extended due date will incur a penalty for failure to file of five percent (5%) for each month or fraction of a month delinquent, with a maximum penalty of twenty-five percent (25%) of the tax and a minimum of five dollars (\$5.00). Additionally, a penalty of ten percent (10%) will be assessed for failure to timely pay any tax shown due with a return and on other remittances not made within thirty days.

Interest

Interest at the rate established by G. S. 105-241.1 of the North Carolina Revenue Laws is due and payable with all payments of tax not remitted by the due date established by statute. The rate is established semiannually by the Secretary.

Tax Overpayments

A corporation may apply a portion or all of the overpayment shown on its return as filed against the estimated income tax liability for the subsequent income year.

Filing of Declarations of Estimated Income Tax

Corporations which expect to have an income tax liability to this State of \$500 or more are required to file declaration Form CD-429 and pay 90% of the estimated tax. Refer to the instructions for this form for time of payment, amount payable, underpayment penalty, etc. **Use the preaddressed coded Form CD-429 when furnished by this Department.**

Requirement for Reporting Federal Changes

A corporation is required to file an amended return if any change is made in its net income by the Federal Government within two (2) years after being notified of the correction or final determination. Penalty is imposed for failure to comply with the filing requirement. (see G. S. 105-130.20)

Suspended Corporation Reinstatement Fee

A corporation which has its articles of incorporation or certificate of authority suspended for failure to comply with this State's revenue laws is required to file all delinquent returns and remit the tax, penalty and interest due plus pay a fee of \$25.00 for reinstatement of its corporate rights.

Income Tax Credits

The following are some of the more utilized credits for corporations. Refer to the Revenue Laws or our Rules and Bulletins for other available credits.

- Credit for construction of solar heating, cooling, or hot water system
- Credit for supervisory fees (savings and loan associations only)
- Credit for construction of installation of hydroelectric generator with at least 3 KW capacity
- Credit for construction or installation of solar equipment for production of heat in the manufacture of service process of a business
- Credit for real property donated for conservation purposes
- Credit for the construction of poultry composting facilities
- Credit for the Rehabilitation of Historic Structures
- Credit for use of North Carolina Ports

The following is a list of **franchise and income tax** incentives for new and expanding businesses:

- Investment Tax Credit
- Job Creation Tax Credit
- Research and Development Tax Credit
- Worker Training Tax Credit
- Central Administrative Office Property Tax Credit
- Business Property Tax Credit

(Computational worksheets for all New and Expanding Tax Credits are enclosed in this booklet. See Forms CD 478 A-F)

Annual Report Fees

Effective for taxable years ending on or after 12-31-97, G.S. 55-16-22 was rewritten to move the collection of the Annual Report fee previously remitted by corporations to the Secretary of State's office to the Department of Revenue. All domestic corporations, as well as, all foreign corporations authorized to transact business in North Carolina except for insurance companies, limited liability companies, nonprofit corporations, and professional associations must on an annual basis, complete Form CD 479 and remit a twenty dollar (\$20.00) fee. The annual report Form, CD 479, must be completed in its entirety and attached to the front page of the completed tax return. Remittance of the Annual Report fee and any franchise and/or income tax shown due should be remitted to the Department of Revenue when filing the tax return. Failure to submit the Annual Report with the tax return may result in an administrative dissolution of the Corporate articles or Certificate of Authority by the Secretary of State's Office as prescribed by statute.

Note: For instructions on how to complete the Annual report, see the Check List for Business Corporations Annual Report found on the reverse side of Form CD-479.

Income Tax Refunds to Wildlife Fund

A corporation entitled to a refund of income taxes paid may elect to contribute all or part of the income tax refund to the Wildlife Fund.

Escheat Law – Abandoned and Unclaimed Property

Every corporation holding property of North Carolina residents which is deemed unclaimed and abandoned under General Statutes Chapter 116B shall certify such holding in its income tax return by checking the appropriate block. Information requests as to required reports, types of property, etc. should be directed to: Escheat Officer, Department of State Treasurer, Albemarle Building, 325 N. Salisbury Street, Raleigh, North Carolina 27611.

INSTRUCTIONS FOR THE COMPUTATION OF FRANCHISE TAX – SCHEDULES A, C, D, and E

Tax Bases

Franchise tax is computed by applying the tax rate of \$1.50 per \$1,000 to the largest of the following three tax bases:

(1) **Capital Stock, Surplus, and Undivided Profits (Schedule C)**

In addition to the items listed in the schedule, include stock subscribed, deferred taxes and all other surplus, reserves, deferred credits, 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 such service or deliver such goods; (2) no part of such 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 since 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 such indebtedness has been added by the debtor corporation on a return filed with this State.

Note: 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.

The term "indebtedness" includes all loans, credits, goods, supplies or other capital of whatsoever nature furnished by a parent, subsidiary, or affiliated corporation. The terms "parent," "subsidiary," and "affiliate" have the meanings specified in G. S. 105-130.6.

The capital stock base may be reduced by the excess of assets of an international banking facility employed outside the United States over liabilities of such corporation owed to foreign persons.

(2) **Investment in Tangible Property in North Carolina (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). In addition to the types of property listed in the schedule, include all other tangible property owned such as supplies and tools. 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 such indebtedness was incurred in the purchase or permanent improvement of real estate. The extent to which such 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.

(3) **Appraised Valuation of Property in North Carolina (Schedule E)**

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

Air or Water Pollution Abatement and Recycling and Resource Recovering Facilities

A corporation may deduct from the Capital Stock, Surplus, and Undivided Profits base, schedule C, and the Investment in Tangible Property tax base, schedule D, the cost of any air cleaning device or sewage or waste treatment plant and pollution abatement equipment described in G. S. 105-122(b). The cost of purchasing and installing equipment or constructing facilities for purpose of recycling or resource recovering of or from solid waste or for the purpose of reducing the volume of hazardous waste generated may also be deducted from these bases. Such deductions shall be allowed only upon certification from the Office of Water and Air Resources, or in the case of recycling and resource recovering facilities, the Department of Health and Human Services, that such facilities, and equipment comply with the respective requirements of those offices.

Cash Basis Corporations

Corporations using the cash basis method of accounting for income tax purposes may not compute the Capital Stock, Surplus, and Undivided Profits base, schedule C, by this method. Assets and liabilities must be accrued and reported for franchise tax purposes.

Change of Income Year

A change of income year automatically establishes a new franchise year. A combination return is required for the short income period. Credit is allowed against the franchise tax on the short-period return to the extent that the new franchise year overlaps the old franchise year. For example, a corporation changes its income year from one ending July 31 to one ending November 30. Franchise tax due on its short-period return would be computed in the following manner:

Net franchise tax per short-period return	\$ 75.00
Less credit:	
Net franchise tax paid on combination return filed for income year immediately preceding short period	\$ 60.00
Less: $\frac{\text{Months in short period}}{\text{Months in year}} \times \$ 60.00$	<u>20.00</u> <u>40.00</u>
Net franchise tax due on short-period return	<u>\$ 35.00</u>

A schedule showing computation of above described credit should be attached to the regular franchise and income tax return.

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 the computation, refer to the Franchise Tax and Corporate Income Tax Rules and Bulletins.

New Corporations

A new corporation (newly incorporated, newly domesticated out-of-state corporation, and/or other corporation commencing business in the state) is required to file within seventy-five (75) days following the close of its first income year of twelve (12) months or less a combined franchise and income tax return with this Department. 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 twelve months unless it is clearly shown that the corporation has adopted a method of accounting using the 52-53 weeks reporting period.

A franchise and income tax return is due annually so long as the corporation remains incorporated, domesticated, or continues to do business in this State.

Inactive Corporations

A corporation which is inactive and without assets is subject annually to a minimum franchise tax of \$35. A return is required containing a statement of the status of the corporation. 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 which intends to dissolve or withdraw through suspension for nonpayment of franchise tax should indicate its intention in writing to the Department.

Dissolution or Withdrawal of Corporate Rights

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 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.

Exempt or Partially Exempt Corporation

Telephone membership corporations and insurance companies are fully exempt from franchise and income taxes. Electric membership corporations are exempt from income tax but are subject to franchise tax as a public utility. Certain corporations organized under Chapter 55-A are exempt from franchise tax and income tax under Sections 105-125 and 105-130.11 respectively, of the General Statutes. However, such corporations are not exempt on "unrelated business income" earned in excess of \$1000 annually. The term "unrelated business income" is the same as defined under the Internal Revenue Code in effect for all other corporations. Such taxable returns are due on or before the 15th day of the fifth month following the close of the taxable year.

Cooperative associations and marketing associations organized under Chapter 54 of the General Statutes are subject to income tax on any net income not refunded on a patronage basis. Cooperatives file on Form CD-418 due on or before the 15th day of the 9th month following the close of the income year.

INSTRUCTIONS FOR THE COMPUTATION OF STATE INCOME TAX - SCHEDULES B, F, G, H, I, J, K, L, and M

To compute State net income or net loss, each corporation simply uses its Federal taxable income as defined in the Internal Revenue Code effective as of September 1, 1998, as a beginning point and adds thereto or deducts therefrom the items described below. (Note: consolidated tax returns are not permitted)

Additions to Federal Taxable Income

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

- (1) Taxes based on or measured by net income by whatever name called and excess profits taxes.
- (2) Interest paid in connection with income exempt from State income tax.
- (3) Contributions deducted on the Federal return.
- (4) 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.
- (5) The amount by which gains have been offset by the capital loss carry-over allowed under the Internal Revenue Code. (All gains recognized on the disposition of assets must be included in determining State net income or loss in the year of disposition.)
- (6) Net operating loss deducted on the Federal return. the Internal Revenue Code.
- (7) Excessive payments to or charges between affiliated corporations.
- (8) The amount of tax credits allowed against N. C. income tax. For those corporations computing North Carolina net income by apportionment and allocation procedures, this amount is added directly to its North Carolina net income.
- (9) The amount of percentage depletion in excess of cost depletion applicable to mines, oil and gas wells and other natural deposits located outside this State.
- (10) The amount allowed under the Code for depreciation for utility plant acquired by a natural gas local distribution company.
- (11) The amount of income the Code allowed the taxpayer to exclude because the income was attributed under Internal Revenue Code Section 925 to a FSC.

Deductions from Federal Taxable Income

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

- (1) Interest income from obligations of the United States or its possessions net of direct or indirect expense related to such income.
- (2) Payments received from affiliated corporations not deductible by such corporation under N. C. law.
- (3) Deductible dividends as provided under G.S. 105-130.7 including dividends received from corporations in which more than 50% of the outstanding voting stock is owned.
- (4) Net economic losses incurred by the corporation in any or all of the five preceding years. There is no corporate NEL carryback deduction available. (Note: The net economic loss carry forward period is extended to fifteen (15) years effective for tax years beginning on or after November 1, 1999.) (see 1998 changes)
A net economic loss is the amount by which allowable deductions, other than prior year losses, exceed income from all sources in the year including any nontaxable income. Nontaxable income includes income deducted from Federal taxable income in computing State net income, nonbusiness income allocated outside this State and other income not taxable under State law. Any nontaxable income received in such succeeding year must be deducted from the loss brought forward in arriving at the allowable net economic loss deduction.
Any corporation which is required to apportion its net income or loss under G. S. 105-130.4 may carry forward to the succeeding year only the allocated portion of the loss less a proportionate amount of any nontaxable income received in the loss year. The amount of any nontaxable income received in such succeeding year multiplied by such succeeding year's apportionment percentage must be deducted from the loss brought forward in determining the allowable net economic loss deduction.
- (5) Contributions to the extent provided under G. S. 105-130.9.
- (6) Amortization in lieu of depreciation allowed for Federal income tax purposes on the cost of qualified sewage, waste or air pollution facilities, recycling and resource recovering facilities, equipment mandated by OSHA and equipment and facilities acquired for the purpose of reducing the volume of hazardous waste generated as provided in G. S. 105-130.10 and G. S. 105-130.10A.
- (7) Depreciation of emergency facilities acquired prior to January 1, 1955 provided no amortization has been claimed on such facilities for State income tax purposes.
- (8) The amount of losses realized on the sale or other disposition of assets not allowed under Section 1211(a) of the Internal Revenue Code. All losses recognized on the disposition of assets must be included in determining State net income or loss in the year of disposition.
- (9) 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.
- (10) The amount of which an ordinary and necessary business expense has been reduced on the Federal income tax return because a tax credit was claimed in lieu of the deduction on that return.
- (11) Reasonable expenses paid for reforestation and cultivation of commercially grown trees by corporation owned entirely by natural persons actively engaged in the commercial growing of trees.
- (12) The amount of eligible income of an international banking facility to the extent included in determining federal taxable income.
- (13) The amount by which the tax basis of certain property is reduced as the result of compliance with federal investment tax credit provisions.
- (14) Marketing assessments paid on tobacco grown in N. C.
- (15) The amount of natural gas expansion surcharges collected by a natural gas local distribution company under G. S. 62-158.
- (16) Interest, net of related expenses, received from North Carolina obligations included in federal taxable income.
- (17) Wireless enhanced 911 service charges collected under G. S. 62B-3 and remitted to the Wireless Fund under G. S. 62B-4.

Other Adjustments to Federal Taxable Income

The following other adjustments to Federal taxable income must be made in determining State net income:

- (1) No deduction is 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 is deductible only in the year of sale or other disposition.
- (2) 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 which has been depreciated or amortized by use of a different basis or rate for State income tax purposes than that used for Federal purposes.
- (3) Deductions are generally not allowed for any direct or indirect expenses related to income not taxed.
- (4) Federal taxable income must be increased or decreased to account for the recovery of previously deducted amounts which differ for state income tax purposes.
- (5) Interest on deposits with the FHLB (savings and loan associations only)

Depreciation Recapture

Any recapture of depreciation required under the Internal Revenue Code must be included in a corporation's State net income to the extent required by Federal law.

Multistate Corporations

A corporation having "business income" from business activity which is taxable both within and without this State is required to apportion its State net income or net loss as computed above, as herein provided. 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. (See page 8 for definitions of certain terms used in these instructions.)

COMPUTATION OF APPORTIONMENT FACTORS

All business income of corporations other than public utilities and excluded corporations shall 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. Provided, that if the sales factor does not exist, the denominator is the existing factors; and, if a property or a payroll factor does not exist, the denominator is the existing factors plus one.

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 shall not be deducted when they constitute business income. Any property under construction or any property which had not been actually used or operated in the corporation's business during the income year and any property the income from which constitutes nonbusiness income shall be excluded in the computation of the property factor.

The average value of property shall be 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 which ceases its operation in this State before the end of its income year for any reason whatsoever shall 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, but the Secretary may require averaging of monthly or other periodic values during the income year.

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 shall 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:

- (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; or
- (3) some of the service is performed in this State and (A) 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, or (B) 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.

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. The receipts from any casual sale of property shall be excluded from both the numerator and the denominator of the sales factor. Where a corporation is not taxable in another state on its business income but is taxable in another state only because of nonbusiness income, all sales shall be 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 shall be considered as 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 shall constitute delivery to the purchaser in this State.

Other sales are in this State if:

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

DIRECT ALLOCATION OF NONBUSINESS INCOME

Rents and royalties from real or tangible personal property, gains and losses, interest, dividends, patent and copyright royalties, and other kinds of income, **if such income items are non-business income**, less related expenses are required to be allocated as set out below. (A detailed explanation of nonbusiness income is contained in Corporation Income Tax Rules and Bulletins. Copies are available upon request.)

Rents and Royalties from Real and Tangible Property

Net rents and royalties from real property located in this State are allocable to this State.

Net rents and royalties from tangible personal property are allocable to this State:

- (1) if and to the extent that the property is utilized in this State, or
- (2) in their entirety if the corporation's commercial domicile is in this State and the corporation is not organized under the laws of, or is not taxable in, the state in which the property is utilized.

The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of

physical location of the property in the state during the rental or royalty period in the income year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the income year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the corporation, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

Gains or Losses on Disposition of Property

Gains and losses from sales or other disposition of real property located in this State are allocable to this State.

Gains and losses from sales or other disposition of tangible personal property are allocable to this State if:

- (1) the property had a situs in this State at the time of the sale, or
- (2) the corporation's commercial domicile is in this State and the corporation is not taxable in the state in which the property had a situs.

Gains and losses from sales or other disposition of intangible personal property are allocable to this State if the corporation's commercial domicile is in this State.

Interest and Dividend Income

Interest income and dividend income, net of any dividends deducted in computing State net income or loss pursuant to G. S. 105-130.7, are allocable to this State if the corporation's commercial domicile is in this State.

Royalties and Similar Income from Intangible Property

Royalties or similar income received from the use of patents, copyrights, secret processes and other similar intangible property are allocable to this State:

- (1) if and to the extent that the patent, copyright, secret process or other similar intangible property is utilized in this State, or
- (2) if and to the extent that the patent, copyright, secret process or other similar intangible property is utilized in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

A patent, secret process or other similar intangible property is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, processing, or other use in the state or to the extent that a patented product is produced in the state. If the basis of receipts from such intangible property does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the intangible property is utilized in the state in which the taxpayer's commercial domicile is located.

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

Other Nonbusiness Income

The income less related expenses from any other non-business activities or investments is allocable to this State if the business situs of the activities or investments is located in this State.

PUBLIC UTILITY CORPORATIONS AND EXCLUDED CORPORATIONS

Special apportionment provisions apply to the business income of public utility corporations and excluded corporations. The respective tax statutes should be consulted for specific allocation requirements. Motor carriers and telephone companies must complete the Computation of Apportionment Factor for Certain Public Service Corporations Worksheet. (see worksheet below) Other public service corporations and excluded corporations compute the apportionment percentage as provided in schedule I, Part III of the North Carolina Franchise and Income Tax Return.

Motor Carriers

All business income of a motor carrier of property or passengers shall 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" shall mean miles traveled by vehicles owned or operated by the company hauling property for a charge or carrying passengers for a fare or traveling on a scheduled route.

Telephone Companies

All business income of a telephone company shall 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.

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 passengers, freight, mail or other cargo carried one mile; each passenger is deemed to weigh 200 pounds.

Excluded Corporations

All business income of an "excluded corporation" shall be apportioned by multiplying the income by the sales factor. (see Part III of schedule I)

Contractors

A multistate building or construction contractor shall 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 published by the Office of Management and Budget. (see Part III of schedule I)

DEFINITIONS

(1) Business income means income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business operations. G.S. 105-130.4(a)(1)

(2) Nonbusiness income means all income other than business income. G.S. 105-130.4(a)(5)

(3) Compensation means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. G.S. 105-130.4(a)(3)

(4) Excluded corporation means any corporation engaged in business as a building or construction contractor, a loan company, a securities dealer, or any other company which receives more than 50 per cent of its ordinary gross income from investments in and/or dealing in intangible property. G.S. 105-130.4(a)(4)

(5) Commercial domicile means the principal place from which the trade or business of the taxpayer is directed or managed. G.S. 105-130.4(a)(2)

(6) Sales means all gross receipts of the corporation except receipts from any casual sale of property and any nonbusiness income receipts. G.S. 105-130.4(a)(7)

(7) Casual sale of property means the sale of any property which was not purchased, produced or acquired primarily for sale in the corporation's regular trade or business. G.S. 105-130.4(a)(8)

(8) State means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof. G.S. 105-130.4(a)(9)

(9) Public utility means any corporation that is subject to control of one or more of the following entities: the North Carolina Utilities Commission, the Federal Communications Commission, the Interstate Commerce Commission, the Federal Power Commission, or the Federal Aviation Agency; and that owns or operates for public use any plant, equipment, property, franchise, or license for the transmission of communications, the transportation of goods or persons, or the production, storage, transmission, sale, delivery, or furnishing of electricity, water, steam, oil, oil products, or gas. The term also includes a motor carrier of property whose principal business activity is transporting property by a motor vehicle for hire over the public highways of this State. G.S. 105-130.4(a)(6)

(10) Franchise tax "doing business" means each and every act, power, or privilege exercised or enjoyed in this State, as a incident to, or by virtue of the powers and privileges granted by the laws of this State. G.S. 105-114(b)(3)

(11) Income tax "doing business" means (a) the operation of any business enterprise or activity in North Carolina for economic gain, including, but not limited to, the following;

- (1) the maintenance of an office or other place of business in North Carolina;
- (2) the maintenance in North Carolina of an inventory of merchandise or material for sale, distribution or manufacture, regardless of whether kept on the premises of the taxpayer or in a public or rented warehouse

(3) the selling or distributing of merchandise to customers in North Carolina directly from a company-owned or operated vehicle when title to the merchandise is transferred from the seller or distributor to the customer at the time of the sale for distribution;

(4) the rendering of a service to clients or customers in North Carolina by agents or employees of a foreign corporation;

(5) the owning, renting, or operating of business or income-producing property in North Carolina including, but not limited to, the following;

- (A) Realty;
- (B) Tangible personal property;
- (C) Trademarks, tradenames, franchise rights, computer programs, copyrights, patented processes, licenses.

(b) Corporations who are partners in a partnership or joint venture operating in North Carolina are considered to be "doing business".

(c) the performance of any of the following business activities in North Carolina (interstate motor carriers only):

- (1) The maintenance of an office in the State;
- (2) The operation of a terminal or other place of business in the State;
- (3) Having an employee working out of the office or terminal of another company;
- (4) Dropping off or gathering up shipments in the State.

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COMPUTATION OF APPORTIONMENT FACTOR FOR CERTAIN PUBLIC SERVICE CORPORATIONS WORKSHEET (Schedule I - Part IV)	
A. <u>Vehicle Miles Factor</u> - for corporations whose business is the operation of a motor carrier of property and/or passengers.	
1. Number of vehicle miles traveled in North Carolina	_____
2. Total number of vehicle miles traveled everywhere	_____
3. Percentage of mileage to N.C. factor (divide line 1 by line 2; enter amount here and on page 4, schedule I, Part IV)	_____ %
B. <u>Gross Operating Revenue Factor</u> - for corporations whose income is derived from the operation of a telephone company.	
1. <u>Gross Operating Revenues in North Carolina</u>	
a. Gross operating revenue from local service in N.C.	_____
b. Gross operating revenue from toll services within North Carolina	_____
c. North Carolina portion of revenue from interstate toll services	_____
d. Gross operating revenues in NC from other services	_____
e. Total gross operating revenues assignable to North Carolina (sum of lines 1a through 1d)	_____
f. Less: North Carolina uncollectible revenue (_____)	_____
g. Total adjusted gross operating revenues assignable to North Carolina	_____
2. <u>Gross Operating Revenues Everywhere</u>	
a. Total gross operating revenues	_____
b. Less: Total uncollectible revenue	(_____) _____
c. Total adjusted gross revenues everywhere	_____
3. Gross operating revenue factor (divide line 1g by line 2c; enter amount here and on page 4, schedule I, Part IV)	_____ %