

H. Investment in Tangible Properties in North Carolina Base (G.S. 105-122(d))

1. Basis For the Investment Base

This base includes the original purchase price plus additions and improvements and less reserve for depreciation permitted for income tax purposes of all tangible property, including real estate located in North Carolina at the end of the income year immediately preceding the due date of the return.

2. What is Includable in the Investment Base (17 NCAC 05B.1302)

Include all tangible assets located in North Carolina at 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. Typical items of tangible property would include: inventory (valued at actual cost or by method consistent with the actual flow of goods), consigned inventories to be included by consignor, machinery and equipment, furniture and fixtures, containers, tools and supplies, land, buildings, leasehold improvements, and all other tangible assets.

3. Treatment of Construction in Progress (17 NCAC 05B.1303)

Construction in progress is excluded from this base only if such property is not owned by the corporation filing the return.

4. Indebtedness Deduction

- a. A deduction from the tangible property base is allowed for existing indebtedness incurred in the purchase or permanent improvement of real estate. The deductible amount cannot exceed the book value (cost less depreciation) of the real estate acquired or improvements made. Indebtedness incurred in the purchase of personal property is not deductible even though the funds borrowed may have been secured by a lien against real estate.
- b. 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 tax base by application of the creditor corporation's borrowed capital ratio.

Example: ABC Corporation owes its parent, XYZ Corporation, \$300,000, which it borrowed for the purchase of real estate. XYZ's borrowed capital from non-affiliated sources is \$500,000 and its assets total \$750,000. Assuming ABC Corporation owns no other tangible property, its tangible property base would be computed as follows:

Investment in real estate					\$300,000
Deductible indebtedness:					
<u>XYZ's borrowed capital</u>	<u>\$500,000</u>				
XYZ'S total assets	\$750,000	x	\$300,000	=	<u>\$200,000</u>
Net tangible property base					\$100,000

- c. When real estate and personal property are acquired at a lump sum price and the specific amount of indebtedness applicable to each type of property cannot be determined, the deductible amount is the proportion of the total amount that the cost assigned to the real estate bears to the total cost of the properties.

Example: ABC Corporation, which operates on a calendar-year basis, purchased an entire plant for \$1,000,000, paying \$100,000 down and giving a mortgage for the balance. Costs were allocated to specific assets as follows:

Land	\$ 50,000
Building	300,000
Machinery and other personal property	<u>650,000</u>
Total purchase price	\$1,000,000

As of December 31, 2003 the balance owed on the mortgage was \$850,000. The amount of indebtedness deductible from total investment in tangible properties on the return due on March 15, 2004 would be computed as follows:

$$\frac{\text{Total cost of land and building } \$ 350,000}{\text{Total cost of plant } \$1,000,000} \times \$850,000 = \$297,500$$

No interest accrued on the mortgage would be deductible or used in the computation.

5. Refinancing of a Loan (17 NCAC 05B.1306)

When an existing loan incurred in the purchase or improvement of real estate is refinanced and additional funds are secured and spent for purposes other than the purchase or improvement of real estate, the deductible portion of the new loan is determined on the basis of the unpaid balance of the old loan to the total of the new loan.

Example: A corporation operating on a March 31 fiscal year purchased land and a building several years ago and incurred a mortgage of \$50,000. The balance of this mortgage at December 31, 2003 was \$30,000. At that time the mortgage was refinanced and the new loan was \$40,000. The additional \$10,000 was used to buy machinery and for working capital. At March 31, 2004 (end of fiscal year), the mortgage was \$39,000.

$$\frac{\text{Unpaid balance of original loan } \$30,000}{\text{Total balance of new loan } \$40,000} \times \$39,000 = \$29,250$$

6. Pollution Abatement Facilities

A deduction from the tangible property base is provided for the cost of any air-cleaning device, or sewage or waste treatment plant, including waste lagoons, and pollution abatement equipment certified by the Department of Environment and Natural Resources or the Environmental Management Commission. Cost should be net of any depreciation on the equipment excluded from the base.

7. Qualifying Recycling, Sewer Service, and Hazardous Waste Facilities

A deduction from the tangible property base is provided for the cost of installing equipment or constructing facilities for the purpose of recycling or resource recovering of or from solid waste certified by the Department of Environment and Natural Resources.

Deductions are also provided for the cost of constructing facilities of any private or public utility built for the purpose of providing sewer service to residential and outlying areas and the cost of equipment and facilities acquired for the purpose of reducing the volume of hazardous waste generated.

For purposes of this section, 'cost' should be net of any depreciation on the equipment or facilities excluded from the tangible property base.

8. Determination of Inclusion Based on Depreciation Deduction (17 NCAC 05B.1309)

When two or more corporations are in doubt as to which should include property, including leased property, in the investment in tangible property base, such property shall be included by the corporation allowed depreciation under the Federal Code.

9. Holding Company

There is no limitation on the franchise tax payable by a holding company on its investment in tangible property tax base.