

L. Corporations Conditionally or Partially Exempt (G.S. 105-122 & 125)

1. Non-Profit Organizations

The following organizations and any other organization exempt from federal income tax under the Code referred to under G.S. 105-130.3 are exempt from franchise tax if they are not organized for profit and if no profit inures to the benefit of any member, shareholder or other individual:

- a. Fraternal societies, orders or associations. To qualify for income tax exemption, the organization must operate under the lodge system or for the exclusive benefit of members of a fraternity that is operating under the lodge system, and provide life, sick, accident or other benefits to the members or their dependents.
- b. Corporations organized or trusts created for religious, charitable, scientific or educational purposes, including cemetery corporations and organizations for the prevention of cruelty to children and animals.
- c. Business leagues, chambers of commerce, merchants associations and boards of trade.
- d. Civic leagues or organizations operated exclusively for the promotion of civic welfare.
- e. Clubs organized and operated exclusively for pleasure, recreation and other non-profit purposes.
- f. Mutual hail, cyclone and fire insurance companies; mutual ditch, irrigation, canning and breeding associations; mutual or cooperative telephone companies; and like organizations of a purely local character which derive their entire income from assessments, dues or fees collected from members for the sole purpose of meeting expenses.
- g. Farmer's marketing associations operating as sales agents to market the products of members or other farmers, and to return to them the proceeds, less the necessary selling expenses, on the basis of the quantity of product furnished by them.
- h. Pension, profit-sharing, stock bonus and annuity trusts established by employers for the purpose of distributing both the principal and income thereof exclusively to eligible employees or the beneficiaries of such employees. There must be no discrimination in favor of any particular employee. The interest of individual employees must be irrevocable and nonforfeitable to the extent of contributions by such employees. Exemption of a trust under the Federal income tax law is a prima facie basis for granting exemption from North Carolina franchise and income taxation.
- i. Condominium associations, homeowner associations or cooperative housing corporations not organized for profit.
- j. Cooperative or mutual associations formed under Section 54-124 of the General Statutes to conduct agricultural business on the mutual plan, and marketing associations formed under Section 54-129 of the General Statutes, are exempt from franchise tax.

2. Corporations Fully Exempt

Corporations which qualify for the full franchise tax exemption are described below:

- a. Insurance companies subject to the tax on gross premiums are exempt from the general business franchise tax. Effective January 1, 2003, health maintenance organizations will be subject to the gross premiums tax and exempt from the general business franchise tax.
- b. Telephone membership corporations organized under Chapter 117 of the General Statutes of North Carolina are exempt from the general business franchise tax. Electric membership corporations are, however, subject to franchise taxes.

3. Regulated Investment Companies and Real Estate Investment Trusts

These are organizations or trusts which qualify under the United States Code as a “regulated investment company” or “real estate investment trust” and file an election to be treated as such with the Revenue Department.

They are required to pay franchise tax; however, in determining their “capital stock, surplus, and undivided profits base” they are allowed to deduct the aggregate market value of investments in the stock, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments.

4. Real Estate Mortgage Investment Conduits (REMIC)

Organizations which qualify under the Code as Real Estate Mortgage Investments Conduits (REMIC) are exempt from franchise tax and are also exempt from income tax to the extent the REMIC is exempt from income tax under the Code.

5. Limited Liability Company (LLC)

The “North Carolina Limited Liability Company Act” (Chapter 57C of the North Carolina General Statutes) permits the organization and operation of limited liability companies (LLC). A LLC is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership. Limited liability companies are not subject to the franchise tax.

Each corporate member of an LLC doing business in North Carolina has nexus in North Carolina, however, not every corporate member is required to file North Carolina corporate income and franchise tax returns. The determining factors are the LLC’s entity classification and each corporate member’s other activities in this State.

If an LLC is treated as a partnership for federal income tax purposes, each corporate member is required to file a corporate income and franchise tax return even if there are no other activities in the State since the LLC’s income, assets, and activities flow through to the members of the LLC. The treatment of a corporate member of an LLC that is treated as a partnership is identical to the treatment of a corporation that is a partner in a partnership.

If the LLC is treated as a corporation for federal tax purposes and each corporate member’s only connection to North Carolina is its ownership interest in the LLC, the corporate member(s) is not required to file a North Carolina corporate income and franchise tax return even though the corporate member(s) has nexus in North Carolina

as a result of its membership in the LLC. The corporate member(s) is not required to file in this circumstance because the LLC reports its North Carolina income at the entity level and the apportionment attributes of the LLC do not flow through to the corporate member(s) as is the case when the LLC is disregarded or is treated as a partnership.

If the LLC is treated as a corporation for federal tax purposes and each corporate member has activities in this State, in addition to its ownership interest in the LLC, that make the corporate member subject to the franchise tax, the corporate member(s) is required to file a corporate income and franchise tax return.

Effective for taxes due January 1, 2002, through December 31, 2002, a corporation that is a member of an LLC and is entitled to receive at least seventy percent (70%) of the LLC's assets upon dissolution, must include the LLC's assets in the corporation's investment in tangible property franchise tax base. The member corporation's investment in the LLC is excludible from the computation of the corporation's capital stock, surplus and undivided profits base. (G.S. 105-114(c)).

Effective for any taxes due on or after January 1, 2003, the income, assets, liabilities, or equity of an LLC are attributed to a corporation if the corporation and its related members together own indirectly seventy percent (70%) or more of the LLC's assets. A person owns indirectly assets of an LLC if the LLC's governing law provided that seventy percent (70%) or more of its assets, after payments to creditors, must be distributed to the person upon dissolution. The LLC's assets are attributed only to the related members that are corporations. None of the LLC's assets are attributed to the related members that are not corporations. Instead, the amount that would be attributed to that member is also attributed to the corporate members. (G.S. 105-114.1) An example of the attribution calculation is included in Item 15, Subsection G "Capital Stock, Surplus and Undivided Profits Base" in this section. The member corporation's actual investment in the LLC is excludible from the member corporation's computation of its capital stock, surplus and undivided profits base.