

N. Transactions Between Affiliated Corporations and Consolidated Returns (G.S. 105-130.5 (a) (9), G.S. 105-130.6)

1. Preliminary Statement

The law provides certain limitations and restrictions on deductions for payments or charges made in connection with transactions between a parent, subsidiary and affiliated corporation. The purpose of these provisions is to prevent a parent, subsidiary or affiliated corporation from reporting a distorted net income to North Carolina by siphoning off its income properly attributable to its operations in North Carolina to an out-of-state parent, subsidiary or affiliated corporation.

2. Deductions for Payments and Charges Must Be Commensurate with Goods and Services Received

In arriving at its state net income, a taxpayer corporation which is a parent, subsidiary or affiliate of another corporation or group of corporations is required to limit any deductions for payments to, or charges by, its parent, subsidiary or affiliated corporation to amounts which are reasonable in relation to the goods or services received therefor.

3. Consolidated Returns

Under State law, a corporation is not permitted to file a consolidated income tax return. However, in certain cases, the law does give the Secretary of Revenue authority to require the filing of a consolidated return.

If the Secretary finds that the net income reported by a parent, subsidiary or affiliated corporation does not represent the true earnings of such corporation on its business carried on in this State, the Secretary may require that such corporation file a consolidated return covering the entire operations of the parent and all subsidiary and affiliated corporations which had transactions with the corporation required to file a return in this state. The Secretary shall then determine the true amount of net income earned by the taxpayer in this State.

The combined net income of the parent and all subsidiary and affiliated corporations that had transactions with the corporation required to file a return in this State shall be apportioned to North Carolina by use of the applicable apportionment formula required to be used by the taxpayer under G.S. 105-130.4. In such cases there shall be included in the apportionment formula the property, payrolls and sales of all corporations for which the consolidated return is made.

If the Secretary finds that the determination of the net income of a parent, subsidiary or affiliated corporation under a consolidated return will produce a greater or lesser figure than the amount of income actually earned in the State, the Secretary may readjust the determination by reasonable methods of computation to make it conform to the amount of income earned in North Carolina. If the corporation disagrees with the Secretary's determination, it may, within 30 days after notice of such determination, submit its objections and an alternative method of determination. The Secretary will consider the alternative method proposed in arriving at a conclusive determination.

4. Subsidiary and Affiliated Corporations Required to Furnish Information Requested by Secretary

The law provides that a parent, subsidiary or affiliated corporation shall report, in its income tax return or otherwise, any information the Secretary “may reasonably require for the determination of the net income taxable under this division.” Failure to furnish such information within thirty days after demand subjects the corporation to a penalty of \$100 for each day’s omission in addition to the penalty provided under G.S. 105-230.

5. Definitions of Subsidiary Corporation, Parent Corporation, and Affiliated Corporation

For the purpose of the provisions of G.S. 105-130.6, a “subsidiary corporation” is a corporation that is controlled either directly or indirectly by another corporation by stock ownership, interlocking directors, or by any other means whatsoever exercised by the same or associated financial interests, whether such control is direct or through one or more subsidiary, affiliated or controlled corporations. A “parent corporation” is a corporation that, by any of the foregoing means, controls another corporation. An “affiliated corporation” is a member of a group of corporations which are controlled directly or indirectly by the same parent corporation or by the same or associated financial interest by stock ownership, interlocking directors, or by any other means whatsoever, regardless of whether such control is through one or more subsidiary, affiliated, or controlled corporations.

6. Transactions Between Affiliated Corporations Closely Examined by the Department

When examining and auditing corporate income tax returns, the Department’s auditors give special attention to income and expense items resulting from transactions between affiliated corporations in order to determine whether the taxpayers have complied with the provisions of G.S. 105-130.6 in reporting their net income.