

K. Change of Income Year (G.S. 105-122(e))

1. Computation of Tax (17 NCAC 05B.1501)

A change in income year automatically establishes a new franchise year. A combined franchise and income tax return is required for the short income period. Credit is permitted on such return against the franchise tax to the extent that the new franchise year overlaps the old year.

Example: A corporation changes its income year from a calendar year to one ending July 31. A combined franchise and income return is required for the short period January 1, 2005 through July 31, 2005 (7 months). Franchise tax paid on the 2004 return applicable to the calendar year 2005 was \$242.88. Franchise tax on the short period would be applicable to the year August 1, 2005 through July 31, 2006, and would be computed as follows:

Total tax due per return	\$268.00
Less credit for portion of prior year's tax:	
Total tax paid on 2004 return	\$242.88
Less amount applicable to short period (7/12 of \$242.88)	<u>141.68</u>
Amount applicable beyond short period	<u>101.20</u>
Net franchise tax due on short period return	\$166.80

G.S. 105-129.5(b) applies in computing the net franchise tax due for the short period. The statutorily computed tax is reduced by current installments and carryforwards of available tax credits, subject to the 50% limitation, before calculating the amount applicable to the short period and the amount applicable beyond the short period.

2. Computation of Tax When Merger is Involved (17 NCAC 05B.1502)

Often when two corporations merge, a question arises concerning which corporation is liable for the franchise tax. If the merger is effective at any time after the close of the submerged corporation's year-end, then the submerged corporation is liable for the tax. If the merger is effective at any time prior to the close of the submerged corporation's year-end, then the surviving corporation is liable for the tax.

Since franchise tax is paid prospectively, 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. The following example illustrates the conditions under which this occurs.

Example: ABC Corporation, whose income year ends July 31, merged into XYZ Corporation, whose income year is the calendar year. The merger occurred on October 31, 2005. ABC filed a combination franchise and income tax return for the year ended July 31, 2005 and paid franchise tax of \$600 applicable to the ensuing year ending July 31, 2006. XYZ filed a combination franchise and income tax return for the calendar year 2006 and paid franchise tax of \$700 applicable to the ensuing calendar year 2007. The assets reflected in ABC's tax base were also reflected in XYZ's tax base since they had been transferred to XYZ in the merger, and therefore, were on its books as of the end of its income year, December 31, 2006. The year to which ABC's payment applied overlapped the year to which XYZ's

payment applied by seven months (January 1, 2007 through July 31, 2007) and reflected a duplication of tax to that extent.

When the conditions illustrated in the above example exist, where, the acquiring corporation acquired the entire assets of the disposing corporation, the acquiring and disposing corporations had different income years, the date of merger or transfer was after the end of the disposing corporation's income year next preceding such transfer but before the beginning of the surviving corporation's income year next following such transfers, and the disposing corporation had paid franchise tax applicable to its income year in which the transfer occurred, the acquiring corporation may compute its franchise tax on its franchise and income tax return for the income year in which the transfer occurred as shown in the following example:

Franchise tax per surviving corporation's return for income year in which transfer occurred					\$700
Less:					
Franchise tax paid by submerged corporation per return for income year immediately preceding transfer					\$600
Number of months between the ending dates <u>on the above returns</u>		<u>5</u>			
Number of months in year		12	x	\$600	= <u>250</u>
Amount pertaining to overlapping months					<u>\$350</u>
Net franchise tax due					\$350