

G. Research and Development Tax Credit (Article 3F of Chapter 105)

1. General Information

a. Administration (G.S. 105-129.51)

Effective for business activities occurring on or after May 1, 2005, any taxpayer, regardless of its type of business, is allowed a tax credit for qualified North Carolina research expenses, if the taxpayer meets the eligibility requirements relating to wage standard, health insurance, environmental impact, and safety and health programs found in G.S. 105-129.4(b), (b2), (b3), and (b4), respectively.

The credit allowed under this section and the credits allowed in G.S. 105-129.10 are exclusive. A taxpayer can elect to take only one of the three credits with respect to its research activities in a taxable year. A taxpayer may elect to take a different credit for different expenses in a subsequent year.

b. Tax election (G.S. 105-129.52)

A taxpayer may claim the credit allowed in Article 3F against either franchise or income tax. The taxpayer must elect the tax against which the credit will be claimed when filing the return on which the credit is first claimed. The election is binding and applies to both the credit and any carryforwards of the credit.

c. Cap (G.S. 105-129.52)

The credit allowed in Article 3F cannot exceed fifty percent (50%) of the amount of tax against which it is claimed, reduced by the sum of all other tax credits allowed against that tax. This limitation applies to the cumulative amount of credit, including carryforwards. Any unused portion of this credit may be carried forward for the succeeding 15 taxable years.

d. Substantiation (G.S. 105-129.53)

Each taxpayer that claims a credit under Article 3F must maintain and make available for inspection any information or records required by the Secretary. The burden of proof for a credit and the amount of the credit rests upon the taxpayer.

e. Forms

The Form NC-478 series is used to calculate and report tax credits, including the Article 3F credits, that are limited to fifty percent (50%) of the taxpayer's tax less the sum of all other credits that the taxpayer claims. Form NC-478I is used to calculate the research and development tax credits without regard to the fifty percent (50%) limitation. Form NC-478 is used to total the specific credits, to determine if the fifty percent (50%) applies, and, if so, to allocate the limited total credit among the specific credits.

f. Sunset (G.S. 105-129.51)

Article 3F is repealed for taxable years beginning on or after January 1, 2009.

2. Definitions (G.S. 105-129.50)

The definitions in section 41 of the Code apply in this Article. Additionally, the following definitions apply also:

a. North Carolina university research expenses

Any amount the taxpayer paid or incurred to a research university for qualified research performed in this State or basic research performed in this State.

b. Period of measurement

Defined in the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13CFR121.104), the period of measurement is used to determine the entity's annual receipts and is determined by how long an entity has been in business.

If the entity has been in business for less than three years, the annual receipts for the period of measurement are the receipts for the period of time for which the entity has been in business divided by the number of weeks in business and multiplied by 52.

If the entity has been in business for three full fiscal years and has not filed a short-period income tax return for any of those three years, the annual receipts for the period of measurement are the total receipts over the last three years divided by three.

If one of the three years' returns is a short-period return, the annual receipts for the period of measurement are the receipts for the short year and the two full years divided by the total number of weeks in the short year and two full years divided by 52.

c. Qualified North Carolina research expenses

Qualified research expenses, other than North Carolina university research expenses, for research performed in this State.

d. Receipts

Defined in the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13CFR121.104), receipts means total income, gross income plus cost of goods sold as reported for federal income tax purposes, less net capital gains or losses and taxes collected for and remitted to a taxing authority to the extent included in gross or total income, proceeds from transactions between the entity and its domestic or foreign affiliates if also excluded from gross or total income on a federal consolidated return, and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

e. Related person

Defined in G.S. 105-163.010 and IRC sections 267(b) or 707(b).

f. Research university

An institution of higher education that:

- Is classified in the most recent edition of 'A Classification of Institutions of Higher Education', the official report of The Carnegie Foundation for the Advancement of Teaching as one of the following:
 - Doctoral/Research Universities, Extensive or Intensive.
 - Masters Colleges and Universities, I or II.
 - Baccalaureate Colleges, Liberal Arts or General.
- Is a constituent institution of The University of North Carolina.

g. Small business

A business whose annual receipts, combined with the annual receipts of all related persons, for the applicable period of measurement did not exceed one million dollars (\$1,000,000).

3. Credit for North Carolina Research and Development (G.S. 105-129.55)

The credit allowed in this article consists of two parts:

a. Credit for qualified North Carolina research expenses

The credit is equal to a percentage of the expenses based on whether the expenses qualify as small business, low tier research, or other research. Only one credit is allowed with respect to the same expenses. If the expenses qualify in more than one category, then the credit is equal to the higher percentage, not both percentages combined. If part of the taxpayer's expenses qualify as low-tier and part of the expenses qualify as other research, the applicable percentages apply separately to each part of the expenses.

If the taxpayer was a small business as of the last day of the taxable year, the applicable percentage is three percent (3%). Research performed in a tier one, tier two, or tier three area is considered low-tier research and the applicable percentage is three percent (3%). Research expenses that do not qualify as small business or low-tier are considered other research.

If other research expenses are greater than zero but not greater than fifty million dollars (\$50,000,000), the applicable percentage is one percent (1%). If other research expenses are greater than fifty million dollars (\$50,000,000), but not greater than two hundred million dollars (\$200,000,000), the applicable percentage is two percent (2%). If other research expenses are greater than two hundred million dollars (\$200,000,000), the applicable percentage is three percent (3%).

b. Credit for North Carolina university research expenses

A taxpayer that has expenses for research performed by an institution within the North Carolina university system is allowed a credit equal to fifteen percent (15%) of the expenses.