

## **C. Computation of Net Income (G.S. 105-130.3, G.S. 105-130.5)**

### **1. Preliminary Statement**

To compute State net income or net loss, a corporation uses its Federal taxable income as defined in the Internal Revenue Code in effect for the tax year for which the return is to be filed as a beginning point and adds thereto or deducts therefrom the items listed below.

To simplify the preparation and filing of its State income tax return, a corporation may attach a copy of its Federal income tax return and supporting schedules in lieu of completing the corresponding schedules in its State return.

### **2. Adjustments to Federal Taxable Income**

The following additions to Federal taxable income must be made in determining State net income:

- a. Taxes based on or measured by net income by whatever name called and excess profits taxes.
- b. Interest paid in connection with income exempt from State income taxation. See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."
- c. The contributions deduction allowed by the Internal Revenue Code.
- d. Interest income earned on bonds and other obligations of other states or their political subdivisions, less allowable amortization on any bond acquired on or after January 1, 1963.
- e. The amount by which gains have been offset by the capital loss carryover allowed under the Internal Revenue Code. All gains recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.
- f. The net operating loss deduction allowed by the Internal Revenue Code.
- g. Payments to or charges by a parent, subsidiary or affiliated corporation in excess of fair compensation in all intercompany transactions of any kind whatsoever.
- h. The amount of all income tax credits claimed against the corporation's income tax liability during the income year. In lieu of the add-back of tax credits to federal taxable income, taxpayers must reduce the amount of credit available by the current income tax rate. See Form CD-425.
- i. Percentage depletion in excess of cost depletion applicable to mines, oil and gas wells and other natural deposits located outside this State.

- j. The amount allowed under the Code for depreciation or as an expense in lieu of depreciation for a utility plant acquired by a natural gas local distribution company, to the extent the plant is included in the company's rate base at zero cost in accordance with G.S. 62-158.
- k. Royalty payments for the use of intangible property in this State made to a related member and deducted as an expense by a payer in arriving at federal taxable income if the election is made under G.S. 105-130.7A for the recipient to exclude the royalty income from its income. Intangible property is defined as copyrights, patents, and trademarks. A taxpayer is not required to add back royalty payments for the use of intangible property in this State made to a related recipient that is organized under the laws of another country if the country has a comprehensive income tax treaty with the United States and imposes a tax on royalty income of the recipient at a rate that is equal to or exceeds the State's corporate income tax rate. See G.S. 105-130.7A for definitions.
- l. The gross income from international shipping activities excluded from federal taxable income because the corporation elects to be subject instead to a tonnage tax under Subchapter R of Chapter 1 of the Code.
- m. The gross income from domestic production activities excluded from federal taxable income under Section 199 of the Code.
- n. The dividend paid deduction allowed to a captive Real Estate Investment Trust. A captive REIT is one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to NC corporate income tax. REITS owned by other REITS or listed Australian property trusts are excluded from the definition.
- o. The amount of a donation to a nonprofit organization for acquisition or lease of renewable energy property made by a taxpayer who claimed a tax credit under G.S. 105-129.16H Effective taxable years beginning on or after January 1, 2008.

The following deductions from Federal taxable income must be made in determining State net income:

- a. Interest upon the obligations of the United States or its possessions, to the extent included in federal taxable income. However, interest upon obligations of the United States shall not be an allowable deduction unless interest upon obligations of the State of North Carolina or any of its political subdivisions is exempt from income tax imposed by the United States. See subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."
- b. Interest (net of expenses) received from obligations of the State of North Carolina, a political subdivision of this State, a commission, authority, or

another agency of this State, and a nonprofit educational institution organized or chartered under the laws of this State to the extent included in federal taxable income.

- c. Payments received from a parent, subsidiary, or affiliated corporation in excess of fair compensation in intercompany transactions which in the determination of the net income or net loss of such corporation were not allowed as a deduction under this State's revenue laws.
- d. Dividends treated as received from sources outside the United States, as determined under section 862 of the Code, net of related expenses, to the extent included in federal taxable income. The netting of related expenses shall be calculated in accordance with G.S. 105-130.5(c)(3) and G.S. 105-130.6A.
- e. Any amount included in federal taxable income under section 78 or section 951 of the Code, net of related expenses.
- f. Net economic losses incurred by the corporation in any or all of the fifteen (15) preceding years pursuant to the provision of G.S. 105-130.8. For specific instructions with respect to net economic loss determination and requirements applicable to multistate corporations, see Subject "Net Economic Loss Carry-Over."
- g. Contributions or gifts made by the corporation within the income year to the extent provided under G.S. 105-130.9. See Subject "Deduction of Contributions."
- h. Amortization in excess of depreciation allowed for Federal income tax purposes on the cost of sewage, waste or air pollution facilities; recycling and resource recovering facilities; or hazardous waste disposal facilities as provided in G.S. 105-130.10. See Subject "Rapid Amortization of Air or Water Pollution Abatement, Recycling and Resource Recovering, Sewage, and Hazardous Waste Facilities."
- i. Depreciation of emergency facilities acquired prior to January 1, 1955. Any corporation shall be permitted to depreciate any emergency facility, as defined in section 168 of the Internal Revenue Code in effect prior to 1976, over its useful life, provided such facility was acquired prior to January 1, 1955, and no amortization has been claimed on such facility for State income tax purposes.
- j. The amount of losses realized on the sale or other disposition of assets not allowable under section 1211(a) of the Internal Revenue Code. All losses recognized on the sale or other disposition of assets must be included in determining State net income or loss in the year of disposition.
- k. The portion of undistributed capital gains of regulated investment companies included in Federal taxable income and on which the Federal tax paid by the

regulated investment company is allowed as a credit or refund to the shareholder under section 852 of the Internal Revenue Code.

- l. The amount by which a deduction for an ordinary and necessary business expense on the corporation's federal income tax return was reduced and not allowable as a deduction because the corporation claimed in lieu of such amount a tax credit against its federal income tax due for the income year.
- m. Reasonable expenses, in excess of deductions allowed for federal income tax purposes, paid for reforestation and cultivation of commercially grown trees, except that the deduction shall be allowed only to those corporations whose real owners are natural persons actively engaged in the commercial growing of trees, or the spouse, siblings, or parents of such persons. In no case shall a corporation be allowed a deduction for the same cultivation or reforestation expenditure more than once.
- n. The amount by which the basis of a depreciable asset has been reduced on account of a tax credit allowed for federal tax purposes.
- o. Market assessments paid by the corporation on tobacco grown in North Carolina.
- p. The amount of natural gas expansion surcharges collected by a natural gas local distribution company under G.S. 62-158.
- q. The amount of 911 service charges collected under G.S. 62A-5 and remitted to a local government under G.S. 62A-6, the amount of wireless Enhanced 911 service charges collected under G.S. 62A-23 and remitted to the Wireless Fund under G.S. 62A-24, to the extent included in federal taxable income. Effective January 1, 2008, the 911 charges imposed under G.S. 62A-43 and remitted to the 911 Fund under that section.
- r. Any interest, investment earnings, and gains of a trust established by two or more manufacturers that signed a settlement agreement with N.C. to settle claims for damages attributable to a product of the manufacturers, if the trust meets all of the conditions set forth in G.S. 105-130.5(b)(18).
- s. Hurricane relief or assistance payments made to taxpayer by the Office of State Budget, Planning, and Management from the Hurricane Floyd Reserve Fund to the extent included in federal taxable income. Compensation paid from the Fund to the taxpayer for goods or services is not deductible.
- t. Royalty payments received for the use of intangible property in this State by a recipient from a payer that is a related member, if the election is made under G.S. 105-130.7A for the payer to exclude the royalty payments from its expenses deduction. Intangible property is defined as copyrights, patents, and trademarks. See G.S. 105-130.7A for definitions.

- u. In each of the taxpayer's first five taxable years beginning on or after January 1, 2005, an amount equal to twenty percent (20%) of the amount added to taxable income in a previous year as accelerated depreciation under G.S. 105-130.5(a)(15). For pass-through entities, the deduction is available only to the taxpayer that reported the addition in arriving at taxable income.
- v. To the extent included in federal taxable income, the amount received from the Disaster Relief Reserve Fund in the Office of State Budget and Management for hurricane relief or assistance. This deduction does not include payments for goods or services provided by the taxpayer.
- w. The amount of dividend received from a captive Real Estate Investment Trust. A captive REIT is one whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are more than fifty percent (50%) owned or controlled by a person subject to NC corporate income tax. REITS owned by other REITS or listed Australian property trusts are excluded from the definition.

Other adjustments to Federal taxable income that must be made in determining State net income are listed below:

- a. In determining State net income, no deduction shall be allowed for annual amortization of bond premiums applicable to any bond acquired prior to January 1, 1963. The amount of premium paid on any such bond shall be deductible only in the year of sale or other disposition.
- b. Federal taxable income must be increased or decreased to account for any difference in the amount of depreciation, amortization, or gains or losses applicable to property that has been depreciated or amortized by use of a different basis or rate for State income tax purposes than used for federal income tax purposes.
- c. No deduction is allowed for any direct or indirect expenses related to income not taxed, except no adjustment is made under this subsection for adjustments addressed in G.S. 105-130.5(a) and (b) and in G.S. 105-130.6A. See Subject: "Attribution of Expenses to Nontaxable Income and to Nonapportionable Income and Property."
- d. Federal taxable income must be adjusted in instances where the taxable income change caused by the recovery of previously deducted amounts may be different for state income tax purposes.
- e. A saving and loan association may deduct interest earned on deposits at the Federal Home Loan Bank of Atlanta to the extent included in federal taxable income.

### **3. Miscellaneous**

#### **a. Depreciation Recapture**

Depreciation recapture under Federal provisions must also be included in State net income. Since depreciation recapture is included in the corporation's federal taxable income, no adjustment is necessary in computing its State net income.

#### **b. Unrealized Income from Installment Sales Taxable upon Termination of Business**

A corporation which withdraws from this State, dissolves, merges, or consolidates its business, or terminates its business in this State by any other means whatsoever is required to file a final income tax return within seventy-five (75) days after the close of business. If the corporation uses the installment method of reporting income, all unrealized or unreported income from installment sales made while doing business in this State must be included in State net income on the final return.

#### **c. International Banking Facility**

Net income or loss from an international banking facility included in the corporation's federal taxable income shall be excluded in determining State taxable income.