

T. Exempt Corporations (G.S. 105-125, G.S. 105-130.11, G.S. 105-130.12)

1. Preliminary Statement

Some types of corporations are fully exempt from income and franchise taxes, whereas others are conditionally or partially exempt, subject to the conditions set out in Item 3 of this section.

2. Corporations Fully Exempt

These corporations qualify for the full income tax exemption:

- Insurance companies subject to the tax on gross premiums are exempt from income tax.
- Telephone membership corporations organized under Chapter 117 of the General Statutes of North Carolina are exempt from income tax. Electric membership corporations are also exempt for income taxes.

3. Corporations Conditionally or Partially Exempt

The following organizations and any organization exempt from Federal Income Tax under the Code are exempt from both franchise tax and corporation income 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 (1) operate under the lodge system or for the exclusive benefit of members of a fraternity that is operating under the lodge system; and (2) 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. Farmers' 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.
- k. 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 required to file an annual income tax return on Form CD-418 and to pay tax on any net income not refunded on a patronage basis on or before the 15th day of the ninth month after close of the income year. They are also required to furnish with this return the names and addresses of all persons paid a patronage refund of ten dollars (\$10.00) or more, and the amount of the refund paid to each.
- l. North Carolina political organizations are exempt from franchise tax, but must file a corporate income tax return if the organization has gross taxable income of more than one hundred dollars (\$100). Organizations must first complete federal Form 1120-POL to determine the organization's federal taxable income. The political organization may attach a copy of its federal return instead of completing Schedule G of Form CD-405. If North Carolina adjustments are applicable, Schedule H must also be completed.

In general a NC political organization must file Form CD-405 by the statutory due date for filing returns. The due date may be extended if the extension, Form CD-419, is received timely. Interest and applicable penalties may be imposed if the organization is required to file Form CD-405 and fails to file the form by the due date. For information on statutory due dates, see Subject "Filing of Returns and Payment of Taxes."

4. Organizations Exempt from Federal Income Tax but not Covered by a Specific Section of the N. C. Statutes

The non-profit organizations and cooperative and mutual associations listed above are not exempt from tax on income received in excess of one thousand dollars (\$1,000) annually from business activities not substantially related to the functions for which

the organizations or associations were formed. However, they are fully exempt from tax on the following income unless such income is classified as unrelated business taxable income under the Code: Interest, royalties, dividends and rentals; income from a business operated without cost to the organization; income from the sale of merchandise donated to the organization; income from a business conducted by a religious, charitable, scientific, or educational organization for the convenience of its members; income derived from research performed by a college, university or hospital, or performed for a governmental unit or agency, or performed by a research organization primarily for the benefit of the public, unless such income is deemed to be related income by the IRS.

Homeowner associations are taxed on gross income (excluding membership income), less allowable deductions. The one thousand dollars (\$1,000) specific deduction does not apply to homeowner associations.

5. 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 a “real estate investment trust” and file an election to be treated as such with the Revenue Department.

They are exempt from income tax only on that part of their net income which is distributed or declared for distribution to shareholders during the income year or by the time required by law for the filing of the return for the income year including the period of any extension of time granted for filing such return.

Captive Real Estate Investment Trusts are required to add to federal taxable income the dividend paid deduction allowed under the Code. A captive REIT is defined as 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 of captive REIT.

6. 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.

7. 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). An LLC is a business entity that combines the S corporation characteristic of limited liability with the flow-through features of a partnership.

North Carolina recognizes the Internal Revenue Service “check the box” regulations for LLC’s. However, this applies only to income tax. Under the federal regulations,

a domestic LLC that is not mandatorily classified nor elects to be classified as a corporation is classified by default as a partnership if it has two or more members. A domestic single-member LLC that is not mandatorily classified nor elects to be classified as a corporation is disregarded as an entity separate from its single owner.

If the only member of a domestic LLC that is disregarded as an entity separate from its single owner is a corporation, the LLC income and expenses are reported on the corporation's return, usually Form 1120 or Form 1120S.

If the only member of the LLC that is disregarded as an entity separate from its single owner is an individual, the activities of the LLC are treated in the same manner as those of a sole proprietorship of the owner.

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.

An LLC is subject to the same provisions that apply to corporations relating to suspension of charter, penalties for operating with a suspended charter and reinstatement rights after suspension of charter.

8. Proof of Exemption

A corporation is not exempt from tax merely because it is not organized and operated for profit. Being formed under Chapter 55A of the General Statutes (the “Non-Profit Corporation Act”) does not automatically entitle a corporation to exemption.

Every corporation claiming exemption as a non-profit organization or as a cooperative or a mutual association must furnish the Secretary of Revenue a copy of its Articles of Incorporation and bylaws, and any other document or information, such as a trust agreement, which may be requested. After reviewing the evidence submitted, the Secretary will notify the corporation whether or not it qualifies for exemption.

The principal factors which are considered in determining taxable status are the corporation’s character; its purposes, the activities in which it will engage; the sources and disposition of its income; whether any of its net income may inure to any private individual; and what disposition will be made of its assets in the event of dissolution.

It is the policy of the Revenue Department, except when the nonprofit nature and intent of the corporation is otherwise clearly indicated, to require that the Articles of Incorporation or bylaws of the corporation contain a specific stipulation that no part of its net income shall inure to the benefit of any private member, shareholder or other individual, either during the existence of the corporation or in the event of its dissolution.

9. Notification of Change In Purposes or Operations

If any change is made in its purposes or method of operation that affects its taxable status, an exempt corporation should promptly notify the Revenue Department of such change.