

State of North Carolina

**FRANCHISE TAX
CORPORATE INCOME TAX
PRIVILEGE TAX
INSURANCE PREMIUM TAX
EXCISE TAX**

2008 SUPPLEMENT

**RULES AND BULLETINS
TAXABLE YEARS 2007 & 2008**

Issued By

Corporate, Excise and Insurance Tax Division
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2008 Supplement to Rules and Bulletins for Taxable Years 2007 & 2008

PREFACE

This publication is a supplement to the Franchise Tax, Corporate Income Tax, Tax Credits, Privilege Tax, Insurance Premium Tax, Excise Tax, and General Administration Rules and Bulletins for Taxable Years 2007 & 2008. This supplement addresses changes to the 2007/2008 Rules and Bulletins resulting from legislative actions, court decisions, Attorney General opinions, rules adopted or amended under the Administrative Procedures Act, Chapter 150B of the General Statutes, or administrative interpretation by the Department of Revenue. This supplement includes only those sections of the 2007/2008 Rules and Bulletins that have been changed.

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I. FRANCHISE TAX

(Article 3)

A. General Information (G.S. 105-114)

2. Corporation Defined

For franchise tax purposes, the term “corporation” includes not only corporations in the usual meaning of the term, but also associations, joint stock companies, trusts and other organizations formed or operating for pecuniary gain which have capital stock represented by shares and privileges not possessed by individuals or partnerships. The term includes limited liability companies that elect to be taxed as corporations for federal income tax purposes.

9. Tax Credit for Limited Liability Companies Subject to Franchise Tax

LLCs that elect to be taxed as corporations for federal income tax purposes are allowed a tax credit against franchise tax equal to the difference between the annual report fee on corporations for filing paper annual reports under G.S. 55-1-22(a)(23) and the annual report fee for limited liability companies under G.S. 57C-1-22(a). The credit allowed may not exceed the franchise tax liability for the year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

C. Holding Companies (G.S. 105-120.2)

1. Definition

A holding company is any corporation that receives more than eighty percent (80%) of its gross income during its taxable year from corporations in which it owns, directly or indirectly, more than fifty percent (50%) of the outstanding voting stock or voting capital interest.

If a holding company has an ownership interest in an LLC doing business in the State and the LLC is treated as a corporation for federal income tax purposes, the holding company’s share of the income of the LLC is included in the denominator and, if the corporation owns more than fifty percent (50%) of the voting capital interest in the LLC, the holding company’s share of the income of the LLC is included in the numerator when computing the holding company test.

E. General Business Corporations (G.S. 105-122)

3. Corporations Required to File

Unless specifically exempt under G.S. 105-125, all active and inactive domestic corporations, and all foreign corporations with a Certificate of Authority to do business, or which are in fact doing business in this State, are subject to the annual franchise tax levied under G.S. 105-122.

If an LLC is treated as a corporation for federal tax purposes and a 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. 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 an LLC is treated as a corporation for federal tax purposes and a corporate member has activities in this State in addition to its ownership interest in the LLC, the corporate member(s) is required to file a corporate income and franchise tax return.

F. Capital Stock, Surplus and Undivided Profits Base (G.S. 105-122(b) & (c))

10. Reciprocal Indebtedness Between Affiliates (17 NCAC 05B.1110)

A corporation which owes indebtedness to a parent, subsidiary or affiliated corporation and at the same time is owed indebtedness by the same parent, subsidiary or affiliated corporation may net the payable and receivable for purposes of the indebtedness computation. If the indebtedness is owed to one corporation and the receivable is due from another corporation, each amount must be treated separately.

All payables are to be added, then, if netting rules apply (and the taxpayer chooses to net) applicable receivables are removed **before** the exclusion factor (see Item F.6 in the Franchise Tax section of the 2007-2008 Rules and Bulletins publication) is applied.

J. Corporate Members of LLCs (G.S. 105-114.1)

(This section does not apply to limited liability companies that are taxed as corporations, but does apply to noncorporate limited liability companies, i.e., limited liability companies that do not elect to be taxed as corporations under the Code.)

L. Corporations Conditionally or Partially Exempt (G.S. 105-122, G.S. 105-125)

3. Regulated Investment Companies and Real Estate Investment Trusts

These organizations are required to pay franchise tax; however, in determining their “capital stock, surplus, and undivided profits base” they are allowed to deduct the aggregate market value of investments in the stock, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments. Captive REITs are not allowed this deduction. A captive REIT is a REIT whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are owned or controlled, at any time during the last half of the tax year, by a person that is subject to tax under this Part and is not a trust or another entity that qualifies as a real estate investment trust under section 856 of the Code or a listed Australian property.

5. 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. Noncorporate limited liability companies are not subject to the franchise tax. A noncorporate limited liability company is an LLC that does not elect to be taxed as a corporation under the Code.

II. CORPORATE INCOME TAX (Article 4)

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

2. Adjustments to Federal Taxable Income

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

- o. The amount of a donation to a nonprofit organization or a unit of State or local government 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.
- p. The applicable percentage of the amount allowed as a special accelerated depreciation deduction under section 168(k) of the Code for property placed in service after December 31, 2007, but before January 1, 2009. In addition, a taxpayer who was allowed a special accelerated depreciation deduction in taxable year 2007 for property placed in service during that period, and whose North Carolina taxable income for that year reflected that accelerated depreciation deduction must add to federal taxable income in the taxpayer's 2008 taxable year an amount equal to the applicable percentage of the deduction amount allowed in the 2007 taxable year. These adjustments do not result in a difference in basis of the affected assets for State and federal income purposes. The applicable percentage under this subdivision is eighty-five percent (85%).

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

- 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. This deduction is allowed only to the extent that a similar credit is not allowed by this Chapter for the amount.
- x. In each of the taxpayer's first five taxable years beginning on or after January 1, 2009, an amount equal to twenty percent (20%) of the amount added to taxable income in 2008 as accelerated depreciation under G.S. 105-130.5(a)(15a). For pass-through entities, the deduction is available only to the taxpayer that reported the addition in arriving at taxable income.
- y. Five percent (5%) of the gross purchase price of a qualified sale of a manufactured home community. A qualified sale is a transfer of land comprising a manufactured home community in a single purchase to a group composed of a majority of the manufactured home community leaseholders or

to a nonprofit organization that represents such a group. To be eligible for this deduction, a taxpayer must give notice of the sale to the North Carolina Housing Agency under G.S. 42-14.3.

III. TAX CREDITS
(Articles 3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H, 3J, 3K and 4)

A. General Tax Credits

8. Credit for Use of North Carolina Ports (G.S. 105-130.41)

a. Credit

An income tax credit is available to a corporation whose waterborne cargo is loaded onto or unloaded from an ocean carrier calling at the North Carolina ports of Wilmington or Morehead City. The credit is allowed against corporate income tax in an amount equal to the excess of the wharfage, handling (in or out) and throughput charges assessed on the cargo for the current taxable year over an amount equal to the average of the charges for the current taxable year and the two preceding taxable years. For purposes of this section, the terms “handling” (in and out) and “wharfage” have the meanings provided in the State Ports Tariff Publications, “Wilmington Tariff, Terminal Tariff #6,” and “Morehead City Tariff, Terminal Tariff #1” and the term “throughput” has the same meaning as “wharfage” but applies only to bulk products, both dry and liquid. The credit sunsets for taxable years beginning on or after January 1, 2014.

13. Credit for Qualifying Expenses of a Production Company (G.S. 105-130.47)

a. Credit

A taxpayer that is a production company and has qualifying expenses of at least two hundred fifty thousand dollars (\$250,000) with respect to a production is allowed a credit against corporate income taxes. The credit is equal to fifteen percent (15%) of the production company’s qualifying expenses. The credit is claimed for the taxable year in which the production activities are completed but includes all of the taxpayer’s qualifying expenses incurred with respect to the production, including qualifying expenses incurred in earlier years. In the case of an episodic television series, an entire season of episodes is one production.

b. Definitions

These definitions apply:

i. Qualifying Expenses

The sum of the total amount spent in this State for the following by a production company in connection with a production, less the amount in excess of one million dollars (\$1,000,000) paid to a highly compensated individual:

- Goods and services leased or purchased. For goods with a purchase price of twenty-five thousand dollars (\$25,000) or more, the amount included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.
- Compensation and wages on which withholding payments are remitted to the Department of Revenue under Article 4A of this Chapter.

- The cost of production-related insurance coverage obtained on the production. Expenses for insurance coverage purchased from a related member are not qualifying expenses.

ii. Highly Compensated Individual

An individual who receives compensation in excess of one million dollars (\$1,000,000) with respect to a single production. If an individual receives compensation in excess of one million dollars (\$1,000,000), only one million dollars (\$1,000,000) of the compensation is included in the production's qualifying expenses. A highly compensated individual is an individual who receives compensation in excess of one million dollars (\$1,000,000) for personal services with respect to a single production, regardless of whether the individual receives the compensation directly from the production company or indirectly from a personal service company or an employee leasing company and regardless of whether the compensation is considered wages or nonemployee compensation.

iii. Production Company (G.S. 105-164.3)

A person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. However, radio productions do not qualify for the credit (see subsection *14.i* below).

iv. Feature Film

A movie that is made for initial distribution in theaters and that is over forty (40) minutes long.

v. Live Sporting Event

A scheduled sporting competition, game, or race that is not originated by a production company, but is originated solely by an amateur, collegiate, or professional organization, institution, or association for live or tape-delayed television or satellite broadcast. A live sporting event does not include commercial advertising, an episodic television series, a television pilot, a music video, a motion picture, or a documentary production where any sporting events are presented through archived historical footage or similar footage taken at least thirty (30) days before it is used.

vi. Related Member

A person that, with respect to the taxpayer during any part of the taxable year, is one or more of the following:

- A related entity.
- A component member.
- A person to or from whom there would be attribution of stock ownership in accordance with section 1563(e) of the Code if the phrase "5 percent or more" were replaced by "twenty percent (20%) or more" each place it appears in that section.

- c. Qualifying Expenses for Compensation and Wages**
Compensation and wages paid to employees for services performed in North Carolina on which income tax withholding payments are remitted to the Department of Revenue are eligible for the tax credit regardless of whether paid to residents or non-residents. Payments for per diem, living allowances, and fringe benefits are eligible to the extent they are included in the recipient's taxable wages subject to federal income tax withholding. The amount paid to an individual through a personal services corporation or through an employee-leasing organization is considered compensation and is subject to the "highly compensated individual" limitations in calculating the allowable credit.
- d. Qualifying Expenses for Services**
Spending for services is eligible for the tax credit regardless of whether paid to residents or non-residents, as long as the services are performed in North Carolina. The amount paid to an individual through a personal services corporation or through an employee leasing organization is subject to the "highly compensated individual" limitation in calculating the allowable credit.
- e. Qualifying Expenses for Goods**
Spending for goods purchased or leased from a North Carolina business is eligible for the tax credit. This includes fuel, food, airline tickets and other goods if purchased or leased from a business located in North Carolina.
- f. Pass-through Entity**
Notwithstanding the provisions of G.S. 105-131.8 and G.S. 105-269.15, a pass-through entity that qualifies for this credit does not allocate the credit among any of its owners. Instead, the pass-through entity is considered the taxpayer for purposes of claiming this credit. If a return filed by a pass-through entity indicates that the entity is paying tax on behalf of the owners of the entity, the credit allowed under this section does not affect the entity's payment of tax on behalf of its owners and cannot be applied against that liability.
- g. Return**
The credit is claimed on Form NC-415 filed for the taxable year in which the production activities are completed. Processing of the credit cannot begin until after the income tax return for the taxable year in which the production activities are completed is filed. The taxpayer must satisfy any tax liability for the tax year in which the tax credit is claimed before the credit will be refunded.
- h. Credit Refundable**
If the credit allowed exceeds the amount of income tax for the taxable year reduced by the sum of all credits allowable, the excess is refundable to the taxpayer. The refundable excess is governed by the same provisions that govern the refund of an income tax overpayment by the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits.

i. Limitations

The amount of credit allowed under this section with respect to a production that is a feature film may not exceed seven million five hundred thousand dollars (\$7,500,000). There is no maximum credit for other types of productions. No credit is allowed under this section for any production that satisfies one of the following conditions:

- It is political advertising.
- It is a television production of a news program or live sporting event.
- It contains material that is obscene, as defined in G.S. 14-190.1.
- It is a radio production.

j. Substantiation

A taxpayer allowed a credit under this section must maintain and make available for inspection any information or records required by the Secretary of Revenue. The taxpayer has the burden of proving eligibility for a credit and the amount of the credit. The Secretary may consult with the North Carolina Film Office of the Department of Commerce and the regional film commissions in order to determine the amount of qualifying expenses. To claim a credit under this section, a taxpayer must notify the Division of Tourism, Film and Sports Development in the Department of Commerce of the taxpayer's intent to claim the production tax credit. The notification must include the title of the production, the name of the production company, a financial contact for the production company, the proposed dates on which the production company plans to begin filming the production, and any other information required by the Division. For productions that have production credits, a taxpayer claiming a credit under this section must acknowledge in the production credits both the North Carolina Film Office and the regional film office responsible for the geographic area in which the filming of the production occurred.

k. Sunset

This credit is repealed for qualifying expenses occurring on or after January 1, 2014.

C. Business & Energy Tax Credits (Article 3B)

5. Credit for Small Business Employee Health Insurance (G.S. 105-129.16E)

d. Sunset

The credit allowed in this section sunsets for taxable years beginning on or after January 1, 2010.

7. Work Opportunity Tax Credit (G.S. 105-129.16G)

A taxpayer who is allowed a federal work opportunity tax credit under Part IV, Subpart F of the Code is allowed to take a credit against its North Carolina corporate income or franchise tax equal to six percent (6%) of the credit allowed under the Code for wages paid during the taxable year for positions located in this

State. A position is located in this State if more than fifty percent (50%) of the employee's duties are performed in this State. This section expires for taxable years beginning on or after January 1, 2012.

8. Credit for Donations to a Nonprofit Organization or Unit of State or Local Government for Acquisition of Renewable Energy Property (G.S. 105-129.16H)

Effective for taxable years beginning on or after January 1, 2008, a taxpayer who donates money to a tax-exempt nonprofit organization or a unit of State or local government for the purpose of providing funds for the organization or government unit to construct, purchase, or lease renewable energy property is allowed a credit under this section if the donation is used for its intended purpose. The amount of the credit is equal to the taxpayer's proportionate share of the credit the nonprofit organization or government unit could have taken under G.S. 105-129.16A if the nonprofit organization or government unit were subject to tax. The credit must be taken in the taxable year the property is placed in service. The installment requirement for nonresidential property in G.S. 105-129.16A does not apply. The nonprofit organization or government unit must provide each taxpayer who made a donation a statement describing the property, setting out the cost of the property, the amount of the credit the organization or government unit could claim if it were subject to tax, and the taxpayer's share of the credit. A taxpayer claiming a credit under this section may not deduct this donation as a charitable contribution.

F. Low-Income Housing Tax Credits (Article 3E)

4. Sunset (G.S. 105-129.45)

Article 3E is repealed effective January 1, 2015. The repeal applies to developments to which federal credits are allocated on or after January 1, 2015.

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

1. General Information

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

Article 3F is repealed for taxable years beginning on or after January 1, 2014.

I. Credit for Mill Rehabilitation (Article 3H)

1. General Information (G.S. 105-129.73 (a))

c. Sunset (G.S. 105-129.75)

The credit expires for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011.

2. Credit for income-producing rehabilitated mill property (G.S. 105-129.71)

a. Credit

A taxpayer that is allowed a federal income tax credit under Code section 47 for making qualified rehabilitation expenditures of at least three million dollars (\$3,000,000) with respect to a certified rehabilitation of an eligible site is allowed

a State credit equal to a percentage of the expenditures that qualify for the federal credit. The credit may be claimed in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenditures associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is:

- Forty percent (40%) of the qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of the eligibility certification.
- Thirty percent (30%) of the qualified expenditures if the eligible site is located in a tier four or five area on the date of the eligibility certification.

3. Credit for nonincome-producing rehabilitated mill property (G.S. 105-129.72)

a. Credit

A taxpayer that is not allowed a federal income tax credit under Code section 47 and that makes qualified rehabilitation expenses of at least three million dollars (\$3,000,00) with respect to a certified rehabilitation of an eligible site is allowed a State tax credit equal to a percentage of the rehabilitation expenses. The credit may be claimed in five equal installments beginning in the year the eligible site is placed in service. If the eligible site is placed in service in phases in different years, the credit may be claimed for each year based on the qualified expenses associated with the phase placed in service during that year. To be eligible for the credit, the taxpayer must provide a copy of the eligibility certification and the cost certification. The amount of the credit is forty percent (40%) of qualified expenditures if the eligible site is located in a tier one, two, or three area on the date of the eligibility certification. No credit is allowed if the eligible site is in a tier four or five area.

V. EXCISE TAX
(Articles 2A, 2C, and 5E)

A. Tobacco Products Excise Tax (G.S. 105-113.2 – G.S. 105-113.40)

30. Discount; Refund (G.S. 105-113.39)

A wholesale dealer or a retail dealer who is primarily liable for the taxes imposed by this Part is allowed to deduct a discount equal to two percent (2%) of the tax due *if* the report is filed and the tax due is paid by the due date. The discount covers expenses incurred in preparing the records and reports required by this Part and the expense of furnishing a bond.

A wholesale dealer or a retail dealer who is primarily liable for the excise tax and is in possession of stale or otherwise unsalable tobacco products upon which the tax has been paid may return the tobacco products to the manufacturer and apply to the Secretary for refund of tax paid, less any discount allowed on the unsalable cigars. The application must be in the form prescribed by the Secretary and must be accompanied by an affidavit from the manufacturer listing the tobacco products returned to the manufacturer by the applicant.

VI. PRIVILEGE TAXES
(Article 2)

E. Attorneys-at-Law and Other Professionals (G.S. 105-41)

Every individual in this State who practices a profession or engages in a business and is included in the following list must obtain a statewide license for the privilege of practicing the profession or engaging in the business from the Secretary. A license required by this section is not transferable to another person. The tax for each license is fifty dollars (\$50.00).

1. Professions and/or Businesses Requiring a Privilege License:

- m. A home inspector licensed under Article 9F of Chapter 143 of the General Statutes.

VII. INSURANCE PREMIUM TAX (Article 8B)

C. Types of Tax and Charges (G.S. 105-228.5, G.S. 58-84-1, G.S. 58-6-25)

There are several types of insurance premium tax applied, according to the type of insurance company and the type of insurance written. Gross and Retaliatory Premium Tax, Additional Property Coverage Contracts Tax are types of insurance premium tax reported. Tax rates, according to the type of insurance written, apply to each type of tax. Printed returns are generated from a computer program provided by the NC Department of Revenue. Printed returns and the completed diskette provided by the Department must be submitted. Other sources of the computer program, if used, must obtain prior approval.

Insurers, Article 65 corporations, health maintenance organizations, and self-insurers are required to pay an Insurance Regulatory Charge in addition to all other fees and taxes. The Insurance Regulatory Charge is a percentage of the gross premium tax liability, exclusive of any additional taxes imposed by G.S. 105-228.8, any credits allowed under G.S. 105-228.5A or G.S. 97-133(a), and any other credits allowed under Chapter 105 of the General Statutes, for the taxable year.

D. Tax Basis (G.S. 105-228.5)

The tax imposed on an insurer is based on gross premiums from business done in the State during the calendar year. Finance charges are included in gross premiums.

In the case of life insurance contracts, including supplemental contracts providing for disability benefits, accidental death benefits, or other special benefits that are not annuities and excluding contracts of reinsurance, gross premiums from business done means all premiums collected in the calendar year. Insurers are allowed to deduct premiums refunded on policies rescinded for fraud or other breach of contract and premiums that were paid in advance on life insurance contracts and subsequently refunded to the insured, premium payer, beneficiary, or estate.

For all other contracts of insurance, including contracts of insurance required to be carried by the Workers' Compensation Act and excluding contracts of reinsurance, gross premiums from business done in the State means all premiums written, or the equivalent thereof in the case of self-insurers under the Workers' Compensation Act, for contracts covering property or risks in this State, whether the premiums are designated as premiums, deposits, premium deposits, policy fees, membership fees, or assessments.

In allocating premiums to this State, no distinction is made between the allocation of premium income from a group insurance policy and premium income from individual insurance policies. Gross premiums from group policies providing coverage for individuals living in this State are taxable by this State and should be allocated to North Carolina regardless of the address of the policyholder, policy owner, or beneficiary. The determining factor is residence of the insured. The allocation exception in G.S. 105-228.5(b1)(1) does not apply with respect to premium income

from insurance policies issued to owners, including trusts, located outside North Carolina but covering North Carolina risks.

If, for any tax year, returned premiums exceed gross premiums collected, insurers may reduce taxable premiums to zero. The general statutes do not provide for the carryforward of any unused returned premiums or the refund of premium taxes on any unused return premiums.

When insurers are ordered by the Department of Insurance to establish escrow accounts of possible premium overcharges, reductions in gross premiums are allowed after any refunds have been paid to insureds, not when the escrows are established.

An insurer may exclude the following in determining gross premiums from business done in this State:

- Premiums properly reported and properly allocated as being received from business done in some other nation, territory, state, or states.
- Premiums received from policies written in federal areas for persons in military service who pay premiums by assignment of service pay.
- Premiums received from policies or contracts issued in connection with the funding of a pension, annuity, or profit-sharing plan qualified or exempt under section 401, 403, 404, 408, 457, or 501 of the Internal Revenue Code as defined in G.S. 105-228.90.
- Premiums or considerations received from annuities, as defined in G.S. 58-7-15.
- Funds or considerations received in connection with funding agreements, as defined in G.S. 58-7-16.
- Medicaid or Medicare premiums, to the extent federal law prohibits their taxation.

E. Tax Rates and Charges (G.S. 105-228.5, G.S. 58-6-25)

Tax rates and charges are as follows:

Workers' Compensation	2.50%
Other taxable contracts	1.90%
Property coverage contracts	.74%
Article 65 Corporations	1.90%
Health Maintenance Organizations	1.90%
Insurance Regulatory Charge (2008)	5.50%*

*Subject to change each year and is established by the General Assembly based on a proposed percentage rate submitted by the NC Department of Insurance sufficient to defray the estimated cost of the operations of the NC Department of Insurance for each upcoming fiscal year.

Effective for taxable years beginning on or after January 1, 2008, the additional statewide and local fire and lightning taxes are repealed and replaced with an

additional tax on property coverage contracts. This additional tax on property coverage is imposed on ten percent (10%) of the gross premiums from policies providing coverage for automobile physical damage and all other property coverage contracts including policies providing coverage for wind damage (see G.S. 105-228.5(d)(3) for definitions).

VIII. GENERAL ADMINISTRATION (Article 9)

A. Statute of Limitations; Assessment Procedure; Appeals Process (G.S. 105-241.6 – G.S. 105-241.23)

Substantial changes were made to the statutes governing the assessments, refunds and appeals processes. The revised processes were generally effective January 1, 2008. The information in this section addresses the revised processes. For information on the processes effective through December 31, 2007, please see the Rules and Bulletins publication for 2005 – 2006 and the 2006 Supplement to the Rules and Bulletins.

2. Procedure for Obtaining a Refund (G.S. 105-241.7)

The Department must refund an overpayment it discovers if the statute of limitations has not expired. A taxpayer may request a refund of an overpayment by filing within the statute of limitations an amended return reflecting the overpayment or filing a claim for refund (form NC-19) that identifies the taxpayer, the type and amount of tax overpaid, the applicable tax period, and the basis for the claim. Identifying the basis for the claim does not limit the taxpayer from changing the basis.

Within six months of receiving the amended return or demand for return the Department must either

- refund the amount requested
- adjust the amount requested, refund the adjusted amount, and provide the taxpayer with a reason for the adjustment. If the refund is less than requested, the adjusted refund is considered a notice of denial for the amount of the requested refund that was not refunded.
- deny the refund in its entirety and send the taxpayer a notice of proposed denial, or
- request additional information concerning the request for refund. If a taxpayer fails to respond to a request for information, the Department must take one of the actions listed above within the later of 1) the remainder of the six-month period; 2) thirty (30) days after receiving the information; 3) a time period mutually agreed upon by the Department and the taxpayer.

If the Department fails to take one of these actions within the required time, the inaction is considered to be a proposed denial of the requested refund. A notice of proposed denial must contain the basis for the proposed denial and the circumstance under which the proposed denial will become final. A proposed denial of a refund by the Secretary is presumed to be correct. A refund does not absolve a taxpayer of a tax liability that may in fact exist. The Secretary may propose an assessment for any deficiency as provided by law.

The Department cannot issue a refund of 1) an amount paid before the final return for the tax year is filed, 2) an overpayment setoff under Chapter 105A or under another setoff debt collection program authorized by law, 3) an income tax overpayment the taxpayer has elected to apply to another purpose as provided by law, or 4) an overpayment of less than three dollars (\$3.00) unless the taxpayer files a written claim for the refund.

A taxpayer can file a protective refund claim to protect his/her right to a potential refund of corporate income or franchise tax based on a contingent event for a taxable period for which the statute of limitations is about to expire. A protective claim is usually based on contingencies such as pending litigation or an ongoing tax audit in another state.

The Department of Revenue will accept a protective claim for refund if

- it is filed before the expiration of the statutory refund claim period;
- it identifies and describes the contingencies affecting the claim;
- it is sufficiently clear and definite to alert the Department of Revenue as to the essential nature of the claim; and
- it identifies the tax schedule and the specific year for which the protective claim is filed.

There is no special form for filing a protective claim. The Department of Revenue will accept any written submission if it meets all the required elements. Upon conclusion of the contingency, a taxpayer may finalize the claim for refund by filing an amended return for the tax year at issue. The six-month period within which the Department must take action on a claim for refund does not begin on a protective refund claim until the amended return perfecting the claim is filed.

It is not necessary for a taxpayer to file a protective refund claim for a year under examination by the Internal Revenue Service if the protective refund claim is based on a contingent event related to the federal examination since, under North Carolina law, a taxpayer has six months after being notified of the federal changes to file an amended return to report the changes.

6. Requesting Review of Proposed Denial of Refund or Proposed Assessment (G.S. 105-241.11)

Any taxpayer who objects to a proposed assessment or proposed denial of refund may request the Department to review the proposed action. The request for review must be filed 1) within forty-five (45) days after the date the notice of the proposed assessment or the proposed denial of refund was mailed to the taxpayer, if delivered by mail, 2) within forty-five (45) days after the date the notice of the proposed assessment or the proposed denial of refund was delivered to the taxpayer, if delivered in person; or 3) at any time between the date that inaction by the Department on a request for refund is considered a proposed denial of the refund and the date the time periods set in the other subdivisions of this subsection expire.

A request for review is considered filed on the date the request is delivered if delivered in person or on the date received by the Department if not delivered in person. A taxpayer requests a review by submitting form NC-242. An assessment for tax shown due on the return but not paid or the application of a refund against debt owed to State or local agency or to the Internal Revenue Service are not subject to review.

9. Final Determination after Department Review (G.S. 105-241.14)

If the Department and the taxpayer are unable to resolve the taxpayer's objection to a proposed denial of refund, the Department must issue a notice of final determination that includes the basis for the final determination and the procedure for the taxpayer to follow for contesting the determination.

If the Department and the taxpayer are unable to resolve the taxpayer's objection to a proposed assessment, the Department must issue a notice of final determination that includes the amount of the tax, interest and penalties due, the procedure the taxpayer must follow to contest the final determination, a statement that the amount due stated on the notice is collectible if the taxpayer does not contest the final determination, and an explanation of the collection options available to the Department if the taxpayer fails to pay the liability reflected on the notice and the remedies available to the taxpayer concerning these collection options. The basis for the determination may be stated on the notice or in a separate document and does not limit the Department from changing the basis.

The Department must conclude its review of the proposed assessment or proposed denial of a refund and issue a final determination within nine months of the date the taxpayer filed the request for review. The Department and the taxpayer may mutually agree to extend the time limit. If the Department fails to issue a final determination within nine months, the validity of the proposed denial of a refund or the proposed assessment is not affected.

Timely protests of proposed assessments or denials of refunds filed before January 1, 2008 and pending as of that date will be considered requests for review under the new law without the taxpayer having to submit a new request. The Department has nine months from January 1, 2008 to conclude its review of the proposed assessment or proposed denial of a refund and issue a final determination if needed.

12A. Class actions (G.S. 105-241.18)

Taxpayers that claim a tax statute is unconstitutional may initiate a class action with the Superior Court of Wake County if the requirements of Rule 23 of the North Carolina Rules of Civil Procedure and the requirements of this section are met. The class action commences on the later of

- (1) The date a complaint is filed in accordance with G.S. 105-241.17 alleging the existence of a class pursuant to Rule 23 of the North Carolina Rules of Civil Procedure.
- (2) The date a complaint filed in accordance with G.S. 105-241.17 is amended to allege the existence of a class.

To serve as a class representative of a class action, a taxpayer must comply with all of the conditions in G.S. 105-241.17 and the taxpayer's claim(s) must be typical of the claims of the class members. A taxpayer who is not a class representative is eligible to become a member of a class if the taxpayer could have filed a claim for refund under G.S. 105-241.7 as of the date the class action commenced or as of a subsequent date set by the court, whether or not the taxpayer actually filed a claim for refund as of that date. An eligible class member who is not a class representative and who indicates a desire to be included in the class in accordance with the procedure approved by the court is not required to follow the procedures in G.S. 105-241.11 through G.S. 105-241.17 for the administrative and judicial review of a request for refund or a proposed denial of a request for refund.

To become a member of a class action, an eligible taxpayer must indicate the desire to be included in the class action in response to a notice of the class action.

The statute of limitations for filing a claim for refund of tax paid due to an alleged unconstitutional statute is temporarily suspended for a taxpayer who is eligible to become a member of a class action. For a taxpayer who joins the class, the suspension period begins on the date the class action is commenced and ends when a court enters any of the following in the class action:

- (1) A final order denying certification of the class.
- (2) A final order decertifying the class.
- (3) A final order dismissing the class action without an adjudication on the merits.
- (4) A final judgment on the merits.

For a taxpayer who does not join the class, the suspension ends when the taxpayer does not affirmatively indicate a desire to be included in the class within the time and in accordance with the procedure approved by the court.

A taxpayer who does not become a member of a class 1) may file and prosecute a claim for refund if the statute of limitations has not otherwise expired for filing the claim, or 2) may contest a pending assessment in accordance with the procedures in G.S. 105-241.11 through G.S. 105-241.17. The effect of an adjudication in a class action on a nonparticipating taxpayer's claim for refund or contest of an assessment is governed by the normal rules relating to both claim and issue preclusion except, if a final judgment is entered in favor of the class, the following applies to an eligible taxpayer who did not become a member of the class:

- (1) The taxpayer is not entitled to receive any monetary relief awarded to the class on account of taxes previously paid by the taxpayer.
- (2) If the taxpayer has been assessed for failure to pay the tax at issue in the class action and the taxpayer has not paid the assessment, then the assessment is abated.

- (3) The taxpayer is relieved of any future liability for the tax that is the subject of the class action."

13. Declaratory Judgments, Injunctions, and Other Actions Prohibited (G.S. 105-241.19)

The remedies provided in G.S. 105-241.11 through G.S. 105-241.18 are the exclusive remedies for disputing the denial of a requested refund, the taxpayer's liability for the tax, or the constitutionality of a tax statute. All other actions, including a declaratory judgment and an injunction to prevent the collection of a tax, are barred.

16. Collection of Taxes (G.S. 105-241.22)

The Department can collect a tax when 1) a taxpayer files a return showing an amount due with the return and does not pay the amount shown due, 2) the Department sends a notice of collection after the taxpayer does not file a timely request for a review of a proposed assessment, 3) the taxpayer and the Department agree on a settlement concerning the amount of tax due. 4) the Department issues a notice of final determination with respect to a proposed assessment and the taxpayer does not file a timely petition for a contested case hearing, 5) a final decision is issued on a proposed assessment of tax after a contested case hearing, or 6) the Office of Administrative Hearings dismisses a petition for a contested case for lack of jurisdiction because the issue is the constitutionality of a statute. The term "tax" includes tax, applicable penalties, and interest.

18. Corrections Based on Information (G.S. 105-251)

When a taxpayer provides information to the Secretary within the statute of limitations and the information establishes that an assessment against the taxpayer is incorrect or that the taxpayer is allowed a refund, the Secretary must adjust the assessment or issue the refund in accordance with the information. This action is a correction of an error by the Department or by the taxpayer and is not part of the process for the administrative or judicial review of a proposed assessment or claim for refund.

C. Penalties and Interest (G.S. 105-228.90 through G.S. 105-236, G.S. 105-241.21, G.S. 105-253)

13. Waiver of Penalty

Any penalty may be waived by the Secretary of Revenue pursuant to the Department of Revenue penalty policy. A request for waiver or reduction of penalty must be in writing and must include an explanation for the request. The Department's Penalty Waiver Policy and form to request waiver (Form NC-5500) are available on the Department's website, www.dornc.com. Interest on the tax cannot be waived or reduced.

Exception: Penalties assessed as the result of a taxpayer engaging in tax strategies whereby income that would otherwise be taxable in North Carolina is shifted out-of-state or in other tax shelter activities that reduce or eliminate North Carolina state taxes will not be waived for any reason.