



Important Notice: Income Tax Adjustments For Code Section 179 Expenses

Note: The Department of Revenue originally issued this Important Notice on April 16, 2014. The Department stated that it had been advised by the staff of the General Assembly that there was a drafting error in the law with respect to the North Carolina investment limitation for taxable year 2013. Session Law 2014-3 amended G.S. 105-130.5B, G.S. 105-134.6A, and G.S. 105-153.6 to increase the North Carolina investment limitation for taxable year 2013 from \$125,000 to \$200,000. This Important Notice amends and supersedes the original Important Notice by correcting the North Carolina investment limitation for taxable year 2013 in the chart and in the eight examples. Other dollar amounts were revised in Examples 3 and 4 to produce results similar to the results in the original Important Notice. There are no other changes to the original Important Notice.

For tax years 2010 through 2013, North Carolina did not conform to the provisions of federal law in its entirety with respect to Code section 179 expensing. North Carolina law provided different dollar and investment limitations as reflected in the table below:

Taxable Year	North Carolina Dollar Limitations	North Carolina Investment Limitations
2010	\$250,000	\$800,000
2011	\$250,000	\$800,000
2012	\$250,000	\$800,000
2013	\$25,000	\$200,000

A corporate or individual income taxpayer that places Code section 179 property in service during a taxable year must add to federal taxable income (federal adjusted gross income for individual income tax purposes for taxable years 2012 and 2013) an amount equal to 85% of the difference between the amount deducted on the federal return for Code section 179 expenses, using the federal dollar and federal investment limitations, and the amount that would be deductible for Code section 179 expenses using the North Carolina dollar and North Carolina investment limitations. If the cost of all qualifying Code section 179 property placed in service during the taxable year exceeds the North Carolina investment limitation for a given year, a taxpayer must reduce the North

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Carolina dollar limitation, but not below zero, by the amount the cost of all qualifying Code section 179 property placed in service during the taxable year exceeds the North Carolina investment limitation. The add-back is calculated as follows:

Add-back = (Deduction on Federal Return – Deduction Using North Carolina Dollar and Investment Limitations) X 85%.

A taxpayer may deduct 20% of the total amount of Code section 179 expense added to federal taxable income (federal adjusted gross income for individual income tax purposes for taxable years 2012 and 2013) in each of the first five taxable years following the taxable year in which the add-back is reported.

For purposes of the examples in this Notice, presume the business income limitation in Code section 179(b)(3) does not apply.

Example 1

John Doe invests \$20,000 in qualifying Code section 179 property during tax year 2013. On his federal return, Mr. Doe deducts \$20,000 in Code section 179 expense. Using North Carolina's dollar and investment limitations, Mr. Doe calculates his State add-back for Code section 179 expense as follows:

Step 1: Compare the total cost of qualifying section 179 property placed in service during 2013 (\$20,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is less than or equal to the North Carolina investment limitation for 2013, John is not required to reduce the North Carolina dollar limitation for 2013.

Step 2: Compare the amount of federal section 179 expense taken in 2013 (\$20,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the amount of federal section 179 expense taken in 2013 is less than or equal to the North Carolina dollar limitation for 2013, John's Code section 179 expense deduction using North Carolina dollar and investment limitations equals his federal Code section 179 expense deduction.

Step 3: Calculate the North Carolina add-back by first subtracting the amount of Code section 179 expense deduction using North Carolina dollar and investment limitations (\$20,000) from the amount of federal section 179 expense (\$20,000), then multiplying the difference (\$0) by eighty-five percent (85%).

$$(\$20,000 - \$20,000) = \$0 \times 85\% = \$0$$

For tax year 2013, John Doe does not have an add-back for Code section 179 expense.

Example 2

ABC Corporation, a C Corporation, invests \$100,000 in qualifying Code section 179 property during tax year 2013. On its federal return, ABC deducts \$100,000 in Code section 179 expense. Using North Carolina's dollar and investment limitations, ABC calculates its State add-back for Code section 179 expense as follows:

Step 1. Compare the total cost of qualifying section 179 property placed in service during 2013 (\$100,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is less than or equal to the North Carolina investment limitation for 2013, ABC is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the amount of federal section 179 expense taken in 2013 (\$100,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the amount of federal section 179 expense taken in 2013 is greater than the North Carolina dollar limitation for 2013, ABC's Code section 179 expense deduction using North Carolina dollar and investment limitations (\$25,000) is less than its federal Code section 179 expense deduction.

Step 3. Calculate the North Carolina add-back by first subtracting the amount of Code section 179 expense deduction using North Carolina dollar and investment limitations (\$25,000) from the amount of federal section 179 expense (\$100,000), then multiplying the difference (\$75,000) by eighty-five percent (85%).

$$(\$100,000 - \$25,000) = \$75,000 \times 85\% = \$63,750$$

For tax year 2013, ABC Corporation's add-back for Code section 179 expense equals \$63,750.

Example 3

XYZ Corporation, a C Corporation, invests \$205,000 in qualifying Code section 179 property during tax year 2013. On its federal return, XYZ deducts \$205,000 in Code section 179 expense. Using North Carolina's dollar and investment limitations, XYZ calculates its State add-back for Code section 179 expense as follows:

Step 1. Compare the total cost of qualifying section 179 property placed in service during 2013 (\$205,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed

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in service during 2013 is \$5,000 greater than the North Carolina investment limitation for 2013, XYZ is required to reduce the North Carolina dollar limitation of \$25,000 by \$5,000.

$$(\$205,000 - \$200,000 = \$5,000 \text{ reduction to} \\ \text{North Carolina } \$25,000 \text{ dollar limitation})$$

Step 2. Compare the amount of federal section 179 expense taken in 2013 (\$205,000) with the North Carolina dollar limitation for 2013 of \$20,000 (\$25,000-\$5,000). Since the amount of federal section 179 expense taken in 2013 is greater than the North Carolina dollar limitation for 2013, XYZ's Code section 179 expense deduction using North Carolina dollar and investment limitations (\$20,000) is less than its federal Code section 179 expense deduction

Step 3. Calculate the North Carolina add-back by first subtracting the amount of Code section 179 expense deduction using North Carolina dollar and investment limitations (\$20,000) from the amount of federal section 179 expense (\$205,000), then multiplying the difference (\$185,000) by eighty-five percent (85%).

$$(\$205,000 - \$20,000) = \$185,000 \times 85\% = \$157,250$$

For tax year 2013, XYZ Corporation's add-back for Code section 179 expense equals \$157,250.

Example 4

Jane Doe invests \$225,000 in qualifying Code section 179 property during tax year 2013. On her federal return, Jane deducts \$225,000 in Code section 179 expense. Using North Carolina's dollar and investment limitations, Jane calculates her State add-back for Code section 179 expense as follows:

Step 1. Compare the total cost of qualifying section 179 property placed in service during 2013 (\$225,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is \$25,000 greater than the North Carolina investment limitation for 2013, Jane is required to reduce the North Carolina \$25,000 dollar limitation by \$25,000.

$$(\$225,000 - \$200,000 = \$25,000 \text{ reduction to} \\ \text{North Carolina } \$25,000 \text{ dollar limitation})$$

Step 2. Compare the amount of federal section 179 expense taken in 2013 (\$225,000) with the North Carolina dollar limitation for 2013 of \$0 (\$25,000-\$25,000). Since the amount of federal section 179 expense taken in 2013 is

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greater than the North Carolina dollar limitation for 2013, Jane's Code section 179 expense deduction using North Carolina dollar and investment limitations (\$0) is less than her federal Code section 179 expense deduction

Step 3. Calculate the North Carolina add-back by first subtracting the amount of Code section 179 expense deduction using North Carolina dollar and investment limitations (\$0) from the amount of federal section 179 expense (\$225,000), then multiplying the difference (\$225,000) by eighty-five percent (85%).

$$(\$225,000 - \$0) = \$225,000 \times 85\% = \$191,250$$

For tax year 2013, Jane Doe's add-back for Code section 179 expense equals \$191,250.

Code section 179 Investments and Pass-through Entities

A corporation or individual, in addition to its own investments in qualifying Code section 179 property, may be an owner of a pass-through entity that also invests in qualifying Code section 179 property. For both federal and North Carolina income tax purposes, the Code section 179 deduction limitations apply both to the pass-through entity and to each of its owners. The pass-through entity determines its Code section 179 deduction subject to the applicable limitations but does not deduct the allowable expense on the pass-through entity tax return. Instead, it allocates the Code section 179 expense deduction among its owners.

For federal income tax purposes, the pass-through entity reports the owner's allocated share of the federal Code section 179 deduction on the owner's federal K-1. For North Carolina income tax purposes, if a pass-through entity has allocated a Code section 179 expense to its owners for federal income tax purposes, the pass-through entity must provide a statement on each North Carolina K-1 that notifies the owner that North Carolina's dollar and investment limitations are different than the federal limitations and an addition may be required on the owner's North Carolina income tax return. The statement must also provide the amount of Code section 179 expense allocated to the owner using the North Carolina limitations. A sample statement follows:

You have been allocated Code section 179 expenses on your federal K-1 based on federal dollar and investment limitations. North Carolina has different dollar and investment limitations and requires an add-back on the North Carolina income tax return for 85% of the difference between the amount deducted on the federal return for Code section 179 expenses and the amount of Code section 179 expenses that would be deductible using the North Carolina dollar and investment limitations. The amount of Code section 179 expenses that would be allocated to you using North

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Carolina's dollar and investment limitations is \$____. Use this amount in calculating the add-back for Code section 179 expense on your North Carolina return.

You are allowed to take a deduction in each of the first five taxable years following the taxable year in which the add-back is reported. The deduction in each of those years is 20% of the add-back.

The pass-through entity does not report the add-back or the subsequent deductions on the pass-through entity income tax return.

The total investment in Code section 179 property by the pass-through entity is not added to the owner's own investments when applying the investment limitation. However, the owner of the pass-through entity must add the amount of Code section 179 expense allocated to it by a pass-through entity to its own Code section 179 investments before applying the dollar limitation.

Example 5

Steve Doe is a 25% owner of DEF Corporation, an S Corporation. DEF invests \$125,000 in qualifying Code section 179 property during tax year 2013. DEF allocates \$31,250 of Code section 179 expense to Steve on his federal K-1. Steve has no other investments in qualifying Code section 179 property and deducts \$31,250 on his federal income tax return. Using North Carolina's dollar and investment limitations, DEF calculates Steve's allocated share of Code section 179 expense for North Carolina tax purposes as follows:

Step 1. Compare the total cost of qualifying section 179 property placed in service by DEF during 2013 (\$125,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is less than or equal to the North Carolina investment limitation for 2013, DEF is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the deductible amount of federal section 179 expense at the DEF (pass-through) level for 2013 (\$125,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the amount of federal section 179 expense for 2013 is greater than the North Carolina dollar limitation for 2013, DEF's Code section 179 property expense allocated to its owners using North Carolina dollar and investment limitations is \$25,000. DEF informs Steve Doe that his pro rata share of DEF's Code section 179 expense using North Carolina dollar and investment limitations is \$6,250.

Using North Carolina's dollar and investment limitations, Steve calculates his State add-back for Code section 179 expense as follows:

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Step 1. Compare the total cost of qualifying section 179 property Steve placed in service during 2013 (\$0) with the North Carolina investment limitation for tax year 2013 (\$200,000). Since Steve's cost of qualifying section 179 property placed in service during 2013 is less than or equal to the amount of North Carolina investment limitation allowed in 2013, Steve is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the amount of Code section 179 expense allocated to Steve from DEF using North Carolina dollar and investment limitations (\$6,250) plus any Code section 179 expense attributed to Steve's own qualifying Code section 179 investments (\$0) with the North Carolina dollar limitation for 2013 (\$25,000). Since the total amount of Steve's allocated share of pass-through Code section 179 expense using North Carolina dollar and investment limitations and his own Code section 179 expense (\$6,250) is less than or equal to the North Carolina dollar limitation for 2013, Steve's Code section 179 property expense using North Carolina dollar and investment limitations is \$6,250.

Step 3: Calculate the North Carolina add-back by first subtracting the amount of section 179 expense using North Carolina dollar and investment limitations (\$6,250) from the amount of federal section 179 expense taken in 2013 (\$31,250), then multiplying the difference (\$25,000) by eighty-five percent (85%).

$$(\$31,250 - \$6,250) = \$25,000 \times 85\% = \$21,250$$

For tax year 2013, Steve Doe's add-back for Code section 179 expense equals \$21,250.

Example 6

UVW Corporation is a 20% owner of 123 Partnership. 123 Partnership invests \$100,000 in Code section 179 property during tax year 2013. 123 allocates \$20,000 of Code section 179 expense to UVW on its federal K-1. UVW also invests \$18,000 in qualifying Code section 179 property and deducts \$38,000 on its federal income tax return. Using North Carolina's dollar and investment limitations, 123 calculates UVW's allocated share of Code section 179 expense for North Carolina tax purposes as follows:

Step 1. Compare the total cost of qualifying section 179 property placed in service by 123 during 2013 (\$100,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is less than or equal to the North Carolina investment limitation for 2013, 123 is not required to reduce the North Carolina dollar limitation for 2013.

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Step 2. Compare the deductible amount of federal section 179 expense at the 123 (pass-through) level for 2013 (\$100,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the amount of federal section 179 expense for 2013 is greater than the North Carolina dollar limitation for 2013, 123's Code section 179 property expense allocated to its owners using North Carolina dollar and investment limitations is \$25,000. 123 informs UVW Corporation that its pro rata share of 123's section 179 expense using North Carolina dollar and investment limitations is \$5,000.

Using North Carolina's dollar and investment limitations, UVW Corporation calculates its State add-back for Code section 179 expense as follows:

Step 1. Compare the total cost of qualifying section 179 property UVW placed in service during 2013 (\$18,000) with the North Carolina investment limitation for tax year 2013 (\$200,000). Since UVW's cost of qualifying section 179 property placed into service during 2013 is less than or equal to the amount of North Carolina investment limitation allowed in 2013, UVW is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the amount of Code section 179 expense allocated to UVW from 123 using North Carolina dollar and investment limitations (\$5,000) plus any Code section 179 expense attributed to UVW's own qualifying Code section 179 investments (\$18,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the total amount of UVW's allocated share of pass-through Code section 179 expense using North Carolina dollar and investment limitations and its own Code section 179 expense (\$23,000) is less than or equal to the North Carolina dollar limitation allowed for 2013, UVW's Code section 179 property expense using North Carolina dollar and investment limitations is \$23,000.

Step 3: Calculate the North Carolina add-back by first subtracting the amount of section 179 expense using North Carolina dollar and investment limitations (\$23,000) from the amount of federal section 179 expense taken in 2013 (\$38,000), then multiplying the difference (\$15,000) by eighty-five percent (85%).

$$(\$38,000 - \$23,000) = \$15,000 \times 85\% = \$12,750$$

For tax year 2013, UVW Corporation's add-back for Code section 179 expense equals \$12,750.

Example 7

RST Corporation is a 40% owner of 909 Partnership. 909 Partnership invests \$80,000 in qualifying Code section 179 property during tax year 2013. 909 allocates \$32,000 of Code section 179 expense to RST on its federal K-1. RST

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also invests \$110,000 in qualifying Code section 179 property and deducts \$142,000 on its federal income tax return. Using North Carolina's dollar and investment limitations, 909 calculates RST's allocated share of Code section 179 expense for North Carolina tax purposes as follows

Step 1. Compare the total cost of qualifying section 179 property placed in service by 909 during 2013 (\$80,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is less than or equal to the North Carolina investment limitation for 2013, 909 is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the deductible amount of federal section 179 expense at the 909 (pass-through) level for 2013 (\$80,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the amount of federal section 179 expense for 2013 is greater than the North Carolina dollar limitation for 2013, 909's Code section 179 property expense allocated to its owners using North Carolina dollar and investment limitations is \$25,000. 909 informs RST Corporation that its pro rata share of 909's section 179 expense using North Carolina dollar and investment limitations is \$10,000.

Using North Carolina's dollar and investment limitations, RST Corporation calculates its State add-back for Code section 179 expense as follows:

Step 1. Compare the total cost of qualifying section 179 property RST placed in service during 2013 (\$110,000) with the North Carolina investment limitation for tax year 2013 (\$200,000). Since RST's cost of qualifying section 179 property placed into service during 2013 is less than or equal to the amount of North Carolina investment limitation allowed in 2013, RST is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the amount of Code section 179 expense allocated to RST from 909 using North Carolina dollar and investment limitations (\$10,000) plus any Code section 179 expense attributed to RST's own qualifying Code section 179 investments (\$110,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the total amount of RST's allocated share of pass-through Code section 179 expense using North Carolina dollar and investment limitations and its own Code section 179 expense (\$120,000) is greater than the North Carolina dollar limitation allowed for 2013, RST's Code section 179 property expense using North Carolina dollar and investment limitations is limited to \$25,000.

Step 3: Calculate the North Carolina add-back by first subtracting the amount of section 179 expense using North Carolina dollar and investment limitations (\$25,000) from the amount of federal section 179 expense taken in 2013

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(\$142,000), then multiplying the difference (\$117,000) by eighty-five percent (85%).

$$(\$142,000 - \$25,000) = \$117,000 \times 85\% = \$99,450$$

For tax year 2013, RST Corporation's add-back for Code section 179 expense equals \$99,450.

Example 8

Sandra Doe is a 10% owner of 777 Partnership. 777 Partnership invests \$60,000 in qualifying Code section 179 property during tax year 2013. 777 allocates \$6,000 of Code section 179 expense to Sandra on her federal K-1. Sandra also invests \$250,000 in qualifying Code section 179 property and deducts \$256,000 on her federal income tax return. Using North Carolina's dollar and investment limitations, 777 Partnership calculates Sandra's allocated share of Code section 179 expense for North Carolina tax purposes as follows

Step 1. Compare the total cost of qualifying section 179 property placed in service by 777 during 2013 (\$60,000) with the North Carolina investment limitation for 2013 (\$200,000). Since the total cost of qualifying section 179 property placed in service during 2013 is less than or equal to the North Carolina investment limitation for 2013, 777 is not required to reduce the North Carolina dollar limitation for 2013.

Step 2. Compare the deductible amount of federal section 179 expense at the 777 (pass-through) level for 2013 (\$60,000) with the North Carolina dollar limitation for 2013 (\$25,000). Since the amount of federal section 179 expense for 2013 is greater than the North Carolina dollar limitation for 2013, 777's Code section 179 property expense allocated to its owners using North Carolina dollar and investment limitations is \$25,000. 777 Partnership informs Sandra that her pro rata share of 777's section 179 expense using North Carolina dollar and investment limitations is \$2,500.

Using North Carolina's dollar and investment limitations, Sandra calculates her State add-back for Code section 179 expense as follows:

Step 1. Compare the total cost of qualifying section 179 property Sandra placed in service during 2013 (\$250,000) with the North Carolina investment limitation for tax year 2013 (\$200,000). Since Sandra's cost of qualifying section 179 property placed into service during 2013 is greater than the amount of North Carolina investment limitation allowed in 2013, Sandra must reduce the North Carolina dollar limitation for 2013 on a dollar for dollar basis, but not below zero. For Sandra, the investment in qualifying Code section 179 property during tax year 2013 (\$250,000) exceeds the North Carolina investment limitation for 2013

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(\$200,000) by \$50,000. Therefore, Sandra's North Carolina dollar limitation for 2013 is reduced to \$0.

Step 2. Compare the amount of North Carolina Code section 179 expense allocated to Sandra from 777 using North Carolina dollar and investment limitations (\$2,500) plus any Code section 179 expense attributed to Sandra's own qualifying Code section 179 investments (\$250,000) with the North Carolina dollar limitation for 2013 (\$0). Since the total amount of Sandra's allocated share of pass-through Code section 179 expense using North Carolina dollar and investment limitations and her own Code section 179 expense (\$252,500) is greater than the North Carolina dollar limitation allowed for 2013, Sandra's Code section 179 property expense using North Carolina dollar and investment limitations is \$0.

Step 3: Calculate the North Carolina add-back by first subtracting the amount of section 179 expense using North Carolina dollar and investment limitations (\$0) from the amount of federal section 179 expense taken in 2013 (\$256,000), then multiplying the difference (\$256,000) by eighty-five percent (85%).

$$(\$256,000 - \$0) = \$256,000 \times 85\% = \$217,600$$

For tax year 2013, Sandra Doe's add-back for Code section 179 expense equals \$217,600. Note that even though 777 Partnership allocated \$2,500 in Code section 179 expense to Sandra for North Carolina income tax purposes, her own investments exceed the North Carolina investment limitation to the extent that the North Carolina dollar limitation for Code section 179 property is \$0.