

**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2001**

**SESSION LAW 2002-136
HOUSE BILL 1670**

AN ACT TO CLARIFY THE EXPENSE ATTRIBUTION LAW AS IT APPLIES TO DEDUCTIBLE DIVIDENDS AND TO PROVIDE LIMITS ON THE POTENTIAL TAX LIABILITY.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-130.5(c)(3) reads as rewritten:

"(c) The following other adjustments to federal taxable income shall be made in determining State net income:

- (3) No deduction is allowed for any direct or indirect expenses related to income not taxed under this Part; provided, no adjustment shall be made under this subsection for adjustments addressed in G.S. 105-130.5(a) and (b). G.S. 105-130.6A applies to the adjustment for expenses related to dividends received that are not taxed under this Part."

SECTION 2. Part 1 of Article 4 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"§ 105-130.6A. Adjustment for expenses related to dividends.

(a) Definitions. – The provisions of G.S. 105-130.6 govern the determination of whether a corporation is a subsidiary or an affiliate of another corporation. In addition, the following definitions apply in this section:

- (1) Affiliated group. – A group that includes a corporation, all other corporations that are affiliates or subsidiaries of that corporation, and all other corporations that are affiliates or subsidiaries of another corporation in the group.
- (2) Bank holding company. – A holding company with an affiliate that is subject to the privilege tax on banks levied in G.S. 105-102.3.
- (3) Dividends. – Dividends received that are not taxed under this Part.
- (4) Electric power holding company. – A holding company with an affiliate or a subsidiary that is subject to the franchise tax on electric power companies levied in G.S. 105-116.
- (5) Expense adjustment. – The adjustment required by G.S. 105-130.5(c)(3) for expenses related to dividends not taxed under this Part.
- (6) Holding company. – Defined in G.S. 105-120.2.

(b) General Rule. – For corporations other than bank holding companies and electric power holding companies, the adjustment under G.S. 105-130.5(c)(3) for expenses related to dividends not taxed under this Part may not exceed an amount equal to fifteen percent (15%) of the dividends.

(c) Bank Holding Companies. – For bank holding companies the adjustment under G.S. 105-130.5(c)(3) for expenses related to dividends not taxed under this Part may not exceed an amount equal to twenty percent (20%) of the dividends.

(d) Electric Power Holding Companies. – For electric power holding companies, the adjustment under G.S. 105-130.5(c)(3) for expenses related to dividends not taxed

under this Part may not exceed an amount equal to fifteen percent (15%) of its total interest expenses.

(e) Cap for Bank Holding Companies. – After calculating the expense adjustment as provided in subsection (c) of this section, each bank holding company must calculate the amount of additional tax that results from the expense adjustments for the holding company and for every corporation in the holding company's affiliated group for the taxable year. If the expense adjustments result in additional tax exceeding eleven million dollars (\$11,000,000) for a taxable year for the affiliated group, the affiliated group may reduce the amount of the expense adjustment so that the resulting additional tax does not exceed this maximum. This maximum applies once to each affiliated group each taxable year, whether or not the group includes more than one bank holding company.

The members of the affiliated group may allocate this reduction among themselves in their discretion. In order to take this reduction, each member of the affiliated group that is required to file a return under this Part and that has dividends for the taxable year must provide a schedule with its return that lists every member of the group that has dividends, the amount of the dividends, and whether the member is a bank holding company. In addition, the schedule must show the expense adjustments for those members whose additional tax as a result of the expense adjustment constitutes the maximum amount. In addition, each member must provide any other documentation required by the Secretary.

If the expense adjustment for an affiliated group is reduced under this subsection, and the return of a member of the group is later changed in a manner that reduces below the maximum the amount of additional tax for the group resulting from the expense adjustment, the Secretary may increase the expense adjustment for any member of the group in order to increase to the maximum the amount of additional tax for the group resulting from the expense adjustment. In this situation, the amount of the increase is considered a forfeited tax benefit with respect to the affiliated group for the purposes of G.S. 105-241.1(e). The date of the forfeiture is the date of the change that triggers the Secretary's authority to increase the expense adjustment. Any member whose expense adjustment the Secretary increases is liable for interest on the amount of the increase at the rate established under G.S. 105-241.1(i), computed from the date the taxes would have been due if the expense adjustment had been calculated correctly on the original return. The amount of the increase and the interest are due 60 days after the date of the forfeiture. A taxpayer that fails to pay the amount of the increase and interest by the due date is subject to the penalties provided in G.S. 105-236.

(f) Credits for Bank Holding Companies. – If the affiliated group of which a bank holding company is a member is eligible for the reduction provided in subsection (e) of this section for a taxable year, the affiliated group is also eligible for a credit equal to two million dollars (\$2,000,000). If the affiliated group of which a bank holding company is a member is not eligible for the reduction provided in subsection (e) of this section for a taxable year, the affiliated group is eligible for a credit equal to the amount of additional tax that results from its expense adjustments in excess of the amount of additional tax that would result from the expense adjustments if the expense adjustment of any bank holding company in the group were equal to fifteen percent (15%) of the holding company's dividends for that taxable year.

A credit allowed by this subsection may be taken in four equal, annual installments beginning with the later of the following taxable year or the taxpayer's taxable year beginning in 2003. The members of the affiliated group may allocate a credit allowed by this subsection among themselves in their discretion.

(g) Credit for Electric Power Holding Companies. – After calculating the adjustment for expenses related to dividends under G.S. 105-130.5(c)(3), each electric power holding company must calculate the amount of additional tax under this Part that results from the expense adjustment for the taxable year. The electric power holding

company is allowed a credit for the following taxable year equal to one-half of this amount of additional tax.

As an alternative to taking this credit against its own tax liability, an electric power holding company may elect to allocate the credit among the members of its affiliated group. In this case, the credit must be taken in four equal installments beginning in the later of the following taxable year or the taxable year for which the taxpayer's final return is due in 2004.

(h) Limitation on Credits. – The credits provided in this section are allowed against the tax levied in this Part and the franchise tax levied in Article 3 of this Chapter. A taxpayer may claim a credit against only one of the taxes against which it is allowed. Each taxpayer must elect the tax against which the credit will be taken when filing the return on which the first installment of the credit is claimed. This election is binding. All installments and carryforwards of the credit must be taken against the same tax.

In order for a member of an affiliated group to take a credit, each member of the affiliated group that is required to file a return under this Part or under Article 3 of this Chapter must attach a schedule to its return that shows for every member of the group the amount of the credit taken by it, the tax against which it is taken, and the amount of the resulting tax. In addition, each member must provide any other documentation required by the Secretary.

A credit allowed in this section may not exceed the amount of tax against which it is taken for the taxable year reduced by the sum of all credits allowable, except tax payments made by or on behalf of the taxpayer. Any unused portion of the credit may be carried forward to succeeding taxable years."

SECTION 3. G.S. 105-130.8(a)(5) reads as rewritten:

"(a) Net economic losses sustained by a corporation in any or all of the 15 preceding income years shall be allowed as a deduction to the corporation subject to the following limitations:

...
(5) For purposes of this section, any income item deductible in determining State net income under the provisions of G.S. 105-130.5 and any nonbusiness income not allocable to this State under the provisions of G.S. 105-130.4 shall be considered as income not taxable under this Part. The amount of the income item considered income not taxable under this Part is determined after subtracting related expenses for which a deduction was allowed under this Part."

SECTION 4. G.S. 105-130.5(b)(3a) reads as rewritten:

"(b) The following deductions from federal taxable income shall be made in determining State net income:

...
(3a) 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. Notwithstanding the proviso in subdivision (c)(3) of this section, the netting of related expenses shall be calculated in accordance with subdivision (c)(3) of this section and G.S. 105-130.6A."

SECTION 5. It is the intent of the General Assembly that the provisions of this act are to remain in effect for taxable years beginning in 2001 and 2002. The Revenue Laws Study Committee shall study the treatment of expenses related to dividends received and other income not taxed and the taxation of affiliated corporations, of holding companies, and of financial institutions under current law. The Committee shall report to the 2003 General Assembly its recommendations for modifying the provisions of this act and other provisions of the taxes on corporations and businesses in order to provide for a more equitable and stable source of revenue. It is the intent of the General Assembly to address the issues raised by this act during the

2003 Regular Session and enact changes effective for taxable years beginning on or after January 1, 2003.

SECTION 6.(a) If a taxpayer meets the condition set out in subsection (c) of this section, then, notwithstanding G.S. 105-163.41, no addition to tax may be made under that statute for a taxable year beginning on or after January 1, 2002, and before January 1, 2003, with respect to an underpayment of corporate income tax to the extent the underpayment was created or increased by Section 3 of S.L. 2001-327. This subsection does not apply to any underpayment of an installment of estimated tax that is due more than 15 days after the date this act becomes law.

SECTION 6.(b) If a taxpayer meets the condition set out in subsection (c) of this section, then, notwithstanding G.S. 105-236(4), the penalty under that statute for a taxable year beginning on or after January 1, 2001, and before January 1, 2002, is waived with respect to failure to pay an amount of corporate income tax due to the extent the amount of tax due was created by Section 3 of S.L. 2001-327. This subsection does not apply to any amount of corporate income tax that was due more than 15 days after the date this act becomes law.

SECTION 6.(c) In order to qualify for the benefit of this section, a taxpayer must pay within 15 days after the date this act becomes law all tax due by that date that was created or increased by Section 3 of S.L. 2001-327.

SECTION 7. This act is effective for taxable years beginning on or after January 1, 2001.

In the General Assembly read three times and ratified this the 1st day of October, 2002.

s/ Beverly E. Perdue
President of the Senate

s/ James B. Black
Speaker of the House of Representatives

s/ Michael F. Easley
Governor

Approved 1:57 p.m. this 3rd day of October, 2002