North Carolina updates Code conformity, enacts CARES Act adjustments

North Carolina Gov. Roy Cooper signed legislation that:

- updates the IRC conformity tie-in date for computing corporate and personal income tax liability;
- requires income tax adjustments for some tax provisions under the Coronavirus Aid, Relief, and Economic Security (CARES) Act;
- extends certain personal income tax adjustments and itemized deduction limits;
- clarifies responsibilities for income tax payments by nonresident partners;
- modifies the franchise tax adjustment for corporations that owe debt to an affiliate;
- extends the limitations period for withholding tax assessments;
- amends the refund provisions for affiliated groups; and
- makes the 6.5% insurance regulatory charge permanent.

Code conformity. The legislation updates the income tax conformity date from January 1, 2019 to May 1, 2020.

Business interest expense adjustment. IRC Sec. 163(j) limits the federal deduction for business interest expenses. The CARES Act increased the limit from 30% to 50% of a taxpayer's adjusted taxable income (ATI). The increase is effective for tax years 2019 and 2020.

North Carolina corporate and personal income taxpayers must add the amount of any federal deduction that exceeds the 30% limit.

PPP loan expenses. The CARES Act allows an exclusion for income from the forgiveness of a Payment Protection Program (PPP) loan. Taxpayers computing North Carolina corporate and personal income tax liability must add any expense deducted on the taxpayer's federal return if:

- the payment of the expense results in PPP loan forgiveness; and
- the taxpayer excludes that income from federal gross income.

Charitable contributions. IRC Sec. 170 generally limits an individual's federal itemized deduction for charitable contributions. The CARES Act temporarily suspended the 60% limit on charitable contributions of cash. An individual can deduct 100% of cash contributions made in 2020.

The 60% deduction limit continues to apply to personal income taxpayers who claim North Carolina itemized deductions for the 2020 tax year. Taxpayers who itemize can carryforward charitable contributions that exceed the limit for tax years beginning on or after January 1, 2021.

The CARES Act also allows a deduction for the 2020 tax year by individuals who do not itemize and made charitable contributions to:

- churches;
- nonprofit schools;
- nonprofit medical institutions; and
- other organizations described under IRC Sec.170(b)(1)(A).

Individuals who claim the new federal deduction must add the amount in determining North Carolina taxable income.

Net operating loss carrybacks. The CARES Act enacted a 5-year carryback period for net operating losses (NOLs) from tax years beginning after 2017 and before 2021. North Carolina personal income taxpayers must add the amount of any federal NOL carryback deduction from those tax years. An addition adjustment also applies to the amount of any federal NOL carryback that the taxpayer does not absorb for that tax year and is carried forward to a later tax year.

Taxpayers can deduct 20% of the North Carolina addback amount for tax years 2021 through 2025.

The addback does not apply to farming losses.

Net operating loss carryforwards. The CARES Act suspended the 80% NOL carryforward deduction limit under IRC Sec. 172 until 2021. North Carolina personal income taxpayers must add the amount of any federal deduction that exceeds the limit for NOLs from tax years 2018 through 2020.

Taxpayers can deduct 20% of the North Carolina addback amount for tax years 2021 through 2025.

Business loss limitation adjustment. IRC Sec. 461(l) prohibits a deduction by noncorporate taxpayers for excess business losses. The CARES Act postponed the limitation for the 2018, 2019, and 2020 tax years.

Taxpayers computing North Carolina personal income tax liability must add excess business losses. The addition does not apply if a taxpayer's NOL addback includes the losses.

Taxpayers can deduct 20% of the North Carolina addback amount for tax years 2021 through 2025.

Employer student loan payments. The CARES Act amended IRC Sec. 127 to provide an exclusion from income for student loan payments by employers. Employees can exclude the payments from income for tax years before 2021.

North Carolina personal income taxpayers must add the amount of the principal or interest excluded from the taxpayer's federal return. The addition applies whether the employer's payment is to the taxpayer or the lender.

Home loan debt forgiveness and higher education expenses. The legislation extends the personal income tax addback through 2020 for:

- the exclusion of income from the forgiveness of home loan debt under IRC Sec. 108; and
- the deduction for higher education expenses under IRC Sec. 222.

Home mortgage interest and real property taxes. The $20,000 limit continues through 2020 for North Carolina itemized deductions of:

- home mortgage interest; and
- real property taxes.

Tax payments by nonresident partners. The managing partner of partnership conducting business in North Carolina must report and pay tax on each nonresident partner's distributive income. The requirement does not apply if a nonresident partner that is not an individual affirms it will pay the tax with its North Carolina:

- corporation;

- partnership; or
- trust or estate income tax return.

A partner must complete and sign the affirmation Form D-403 NC-NPA each tax year.

Franchise tax adjustment. Effective for tax years beginning after 2020, a corporation computing franchise tax liability must add debt it owes if the debt creates a net interest expense. A net interest expense is interest paid or accrued to a related entity.

The addition applies to the net worth base of the tax reported on 2020 and later corporate income tax returns.

Affiliated group refunds. North Carolina can redetermine the income of a corporation if it finds that intercompany transactions between affiliated group members lack economic substance or are not at fair market value. It will not issue a refund to an affiliated group member after the redetermination until a proposed assessment to the group member has become collectable.

Withholding tax assessments. If a taxpayer fails to pay all income withholding tax, the limitations period for assessment is the later of:

- 10 years after the return due date; or
- 10 years after the taxpayer filed the return.

North Carolina did not previously have a special limitations period for withholding tax assessments. The standard 3-year limitations period applied. (*Ch. 2020-58, H.B. 1080), Laws 2020, effective June 30, 2020 and as noted.*)