



# North Carolina Enacts Legislation That Updates IRC Conformity Date and Decouples From Some Provisions of the CARES Act

## Summary

**On June 30, 2020**, Governor Cooper signed House Bill 1080 (HB 1080) into law. The omnibus tax bill contains many updates to the various taxes imposed by North Carolina. However, this alert primarily focuses on changes to North Carolina's corporate and personal income taxes. Notably, the bill updates North Carolina's IRC conformity date, while also decoupling from certain provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

**North Carolina updated** its IRC conformity date to May 1, 2020. At the same time, HB 1080 effectively maintained conformity to the Tax Cuts and Jobs Act (TCJA) version of IRC Sections 163(j), 170, 172, and 461(l) by specifically decoupling from the CARES Act provisions related to those sections.

## Details

### IRC Conformity Date Updated

For both corporate and personal income tax purposes, HB 1080 updates North Carolina's IRC conformity date from January 1, 2019, to May 1, 2020. As a result, North Carolina's tax code incorporates changes made by the CARES Act. However, HB 1080 then specifically decouples from various provisions of the CARES Act, which are discussed below.

### Business Interest Limitation

HB 1080 decouples from the CARES Act changes to IRC Section 163(j) for the 2019 and 2020 tax years. The CARES Act increases the business interest expense deduction limitation by increasing the amount of adjusted taxable income (ATI) included in the calculation from 30% to 50%. North Carolina taxpayers must add back any federal deduction of business interest for 2019 and 2020 that, due to the CARES Act amendments, exceeds what would have been the deduction under the IRC "as enacted as of January 1, 2020." Therefore, this addition modification

appears to not only decouple from the increase to the federal 30% ATI limit to 50% under the CARES Act, but also the election to substitute 2019 ATI for 2020.

### Net Operating Losses

For individual taxpayers, HB 1080 decouples from the CARES Act's provision related to federal net operating losses (NOLs) under IRC Section 172. For the 2018 through 2020 tax years, the CARES Act allows NOLs to be carried back five years, and it temporarily suspends the 80% NOL usage limitation from the TCJA. Therefore, taxpayers carrying back NOLs generated in the 2018 through 2020 tax years for federal purposes will not be allowed a North Carolina NOL carryback for personal income tax purposes. Similarly, individual taxpayers claiming an NOL deduction in excess of the TCJA 80% taxable income limitation will be required to add back the excess for North Carolina personal income tax purposes. These North Carolina additions can be deducted over five equal installments between the 2021 and 2025 tax years.

This addback provision does not apply to farming losses.

The bill did not need to decouple from IRC Section 172 for corporate income tax purposes, since North Carolina already decouples from IRC Section 172 in favor of its own corporate income tax NOL calculation.



## Excess Business Losses for Noncorporate Taxpayers

HB 1080 decouples from the CARES Act's delay of the TCJA's \$500,000 limit (\$250,000 if filing separately) on the deduction of excess business losses for noncorporate taxpayers, found under IRC Section 461(l). The CARES Act temporarily suspended the TCJA's limitation on the deduction of excess business losses until 2021. Therefore, noncorporate taxpayers must add back any business losses deducted for federal purposes in 2018, 2019, or 2020 to North Carolina taxable income that exceed the limitation set by TCJA. Similar to the NOL provisions, these North Carolina additions can be deducted over five equal installments between the 2021 and 2025 tax years.

## PPP Loan Expenses

HB 1080 conforms to the CARES Act Section 1106(i)'s exclusion from gross income any forgiven Paycheck Protection Program (PPP) loans that are used on payroll, rent, or utility payments during COVID-19. However, the IRS recently stated in Notice 2020-32 that covered expenses related to forgiven PPP loans cannot be deducted. HB 1080 takes the same position as the IRS and requires taxpayers to add back any expenses deducted for federal purposes that were paid for by a forgiven PPP loan.

## Charitable Contributions

For personal income tax purposes, HB 1080 decouples from the CARES Act, Section 2205 provision that temporarily suspends the limits on charitable contributions for the 2020 tax year.

## Franchise Tax Adjustment

Effective for the 2021 franchise tax year reported on 2020 income tax returns, HB 1080 amends the franchise tax adjustment for affiliated indebtedness to make it consistent with the income tax guidance and to simplify the franchise tax calculation. An addition is required to the franchise tax base for the amount of indebtedness that creates net interest expense, but that does not create qualified interest expense as defined in the corporate income tax statutes.

The corporate income tax provisions impose limitations on the amount of related entity interest expense that is deductible. Specifically, only the qualified interest expense (determined using the taxpayer's proportionate

share of interest calculation) from an affiliate is deductible, unless a related party addback exception applies. When related party indebtedness generates an interest expense addback discussed above for income tax purposes, the associated indebtedness would also be added back to the franchise tax base.

## Nonresident Partner Tax Payments

HB 1080 clarifies the procedure a nonresident pass-through entity (PTE) member (who is not an individual) must follow to be exempt from the PTE being required to pay tax on behalf of the nonresident owner. The nonresident owner must submit to the PTE manager an annual affirmation statement by the due date of the PTE's business information return stating that the nonresident owner will pay the tax directly on their own corporate, partnership, trust, or estate income tax return.

## Affiliated Group Refunds

HB 1080 provides additional procedures related to processing refunds when the North Carolina Department of Revenue makes adjustments to intercompany transactions through redetermining net income or requiring combination.

## Insights

- Due to the IRC conformity date being updated to May 1, 2020, North Carolina conforms to the CARES Act's Qualified Investment Property (QIP) technical correction. However, the state still decouples from federal bonus depreciation under IRC 168(k).
- In addition to the changes outlined above, HB 1080 made various excise tax changes, and it made various sales and use tax changes. It also extends the sunset on the Jobs Development Investment Grant Program from July 1, 2021, to July 1, 2030. The program awards cash grants on competitive projects to encourage investment and jobs in North Carolina.
- HB 1080 enacts a 10-year statute of limitations applicable to trust taxes (e.g., sales and use tax and income tax withholdings) collected, but not remitted to the state. If a taxpayer collects taxes on behalf of North Carolina, but fails to remit those taxes, the statute of limitations for proposing an assessment is the later of 10 years after the return due date; or 10 years after the taxpayer filed the return. The previous statute of limitations in these circumstances was three years.