January 15, 2015

IMPACT OF THE FEDERAL TAX INCREASE PREVENTION ACT OF 2014 ON NORTH CAROLINA'S CORPORATE AND INDIVDUAL INCOME TAX RETURNS

North Carolina's corporate income tax law uses federal taxable income as the starting point in determining North Carolina taxable income. North Carolina's individual income tax law uses federal adjusted gross income as the starting point in determining North Carolina taxable income. In both cases, the reference to federal law is to the Internal Revenue Code ("Code") as of a certain date. Currently, that reference is to the Code as of December 31, 2013. Each year the General Assembly determines whether to update its reference to the Code. Doing so would make recent amendments to the Code applicable for North Carolina income tax purposes. In some cases, the General Assembly chooses not to follow ("decouple" from) certain amendments to federal law.

On December 19, 2014, President Obama signed into law the Tax Increase Prevention Act of 2014 ("TIPA"). The Act extended several provisions in federal law that had sunset at the end of 2013. If the General Assembly does not update the reference to the Code to December 19, 2014 or later, the extension of those provisions will not apply for North Carolina income tax purposes.

The Revenue Laws Study Committee is charged with studying North Carolina's revenue laws and making recommendations with respect to those laws to the General Assembly. On January 13, 2015, the Revenue Laws Study Committee adopted a recommendation to update the reference to the Code to January 1, 2015 but to decouple from specific provisions in TIPA. The recommended bill may be viewed here.

If the General Assembly enacts legislation to update the Code reference as recommended, North Carolina will require additions on the corporate and individual income tax returns for (a) 85% of the amount deducted as bonus depreciation on the federal return and (b) 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 set out for 2014. For individual income tax returns, additions would also be required for (a) the amount excluded from gross income for the discharge of qualified principal residence indebtedness, (b) the amount deducted in arriving at adjusted gross income for qualified tuition and related expenses, and (c) the amount excluded from gross income for a qualified charitable distribution from an individual retirement plan by a person who has attained age 70 ½. In addition, an individual would also be required to exclude amounts paid for mortgage insurance premiums from the deduction for qualified residence interest if the taxpayer claims itemized deductions on the North Carolina return.

Any person filing a North Carolina income tax return whose 2014 federal taxable income or federal adjusted gross income is impacted by the amendments to federal law included in TIPA should consider waiting to file the 2014 North Carolina income tax return until the General Assembly takes action. A taxpayer who files the 2014 income tax return before the General Assembly takes action may have to amend the return to reflect the General Assembly's action. The General Assembly is scheduled to convene on January 28, 2015. If the General Assembly enacts legislation to update the Code reference, the Department will provide additional guidance, including how to report any required additions on the 2014 returns.

D-407A
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Instructions for Estates and Trusts Income Tax Return

2014

North Carolina Department of Revenue

The references to line numbers and form numbers on federal income tax forms were correct at the time of printing. If they have changed and you are unable to determine the proper line to use, please contact the Department of Revenue. These instructions are to be used as a guide in the preparation of a North Carolina estates and trusts income tax return and are not intended to cover all provisions of the law.

Do not attach a copy of Federal Form 1041 or copies of K-1s to Form D-407. If copies are needed, the Department will request them at a later date.

(A) Who must file Form D-407 - A fiduciary must file North Carolina Form D-407 for the estate or trust if he is required to file a federal income tax return for estates and trusts and (1) the estate or trust derives income from North Carolina sources or (2) the estate or trust derives any income which is for the benefit of a resident of North Carolina. **Exception:** With respect to grantor trust returns, the Department of Revenue has access to the federal information contained in the federal grantor trust returns. Therefore, a State grantor trust return is not required to be filed when the entire trust is treated as a grantor trust for federal tax purposes.

(B) Other returns to be filed by fiduciaries:

(1) Returns for decedents - A personal representative must file an individual income tax return, Form D-400, for the last taxable year of the decedent if the decedent had income that was sufficient to require the filing of an individual income tax return.

(2) Returns for other individuals - A fiduciary, including the guardian of a minor (who has not filed a return) and the guardian of a mentally incompetent individual who has charge of the income of the individual, must file a return on Form D-400 if a return is required for such an individual.

(C) Period to be covered by the return - Returns shall be filed for the calendar year 2014 or fiscal year beginning in 2014. If the return is filed for other than a calendar year, fill in the beginning and ending dates of the taxable year in the boxes at the top of page 1.

(D) Time and place for filing - Returns must be filed with the **North Carolina Department of Revenue, P. O. Box 25000, Raleigh, North Carolina 27640-0645,** on or before the 15th of April for an estate or trust filing on the calendar year basis, and on or before the 15th day of the fourth month following the close of the fiscal year for an estate or trust filing on a fiscal year basis.

(E) Extensions - If Form D-407 cannot be filed by the due date, the fiduciary may apply for an automatic 6-month extension of time to file the return. **To receive the extension, the fiduciary must file Form D-410P, Application for Extension for Filing Partnership, Estate, or Trust Tax Return, by the original due date of the return.**

The fiduciary is not required to send a payment of the tax it estimates as due to receive the extension; however, it will benefit the estate or trust to pay as much as it can with the extension request.

A 10 percent late payment penalty will apply on the remaining balance due if the tax paid by the original due date of the return is less than 90 percent of the total tax due. If the 90 percent rule is met, any remaining balance due must be paid with the estate or trust return on or before the expiration of the extension period to avoid the late payment penalty. A fiduciary may file the return at any time within the extension period but it must be filed on or before the end of the extension period to avoid the late filing penalty.

(F) Signature - The fiduciary or authorized representative must sign Form D-407. The return must also be signed by the person or in the name of the firm or corporation preparing the fiduciary's return for compensation. The daytime telephone number of the fiduciary should be shown so that he may be reached if additional information is needed to process the return. **For tax due returns only,** the preparer's facsimile signature is acceptable provided the preparer submits with the return a letter, manually signed by the preparer, identifying each return bearing the facsimile signature by taxpayer name and identifying number and a declaration under penalty of perjury that the facsimile signature on each return is the signature used by the preparer to sign the return.

(G) When and to whom the tax must be paid - The tax of an estate or trust must be paid in full when the return is filed. The tax may be paid by check or money order payable in U.S. dollars to the North Carolina Department of Revenue. **Important:** The Department will not accept a check or money order unless it is drawn on a U.S. (domestic) bank and the funds are payable in U.S. dollars.

(H) Penalties and interest - For failure to file a timely estate or trust return, the penalty is 5 percent of the tax per month with a 25 percent maximum. Returns filed after April 15 without a valid extension are subject to a late payment penalty of 10 percent of the unpaid tax. In addition, penalties are provided for fraud, for willful failure to file on time, and for willful attempt to evade or defeat the tax. Taxes also bear interest from the due date until the date paid.

(I) Copy of governing instrument - A copy of the decedent's will or the trust instrument is not required unless the Department of Revenue requests it. If the Department requests it, file a copy (including any amendments) with the following:

(1) A signed statement under affirmation that the copy of the will is true and complete.

(2) A statement listing the provisions of the will or the trust instrument that divide the income among the estate or trust and the beneficiaries.

(J) Specific Instructions for Form NC K-1 - Schedule NC K-1 for Form D-407 is used by an estate or trust to report each beneficiary's share of income, adjustments, tax credits, etc. Prepare and give a Schedule NC K-1 to each person who was a beneficiary of the estate or trust at any time during the year. Schedule NC K-1 must be provided to each beneficiary on or before the day on which the estate or trust return is required to be filed.

(K) N. C. Education Endowment Fund Contribution - You may contribute to the N. C. Education Endowment Fund by making a contribution or designating some or all of your overpayment to the Fund. To make a contribution, simply enclose Form NC-EDU and your payment. You can access Form NC-EDU online at www.dornc.com. If you owe additional tax on your return and would also like to make a contribution to the fund, you may write one check payable to "North Carolina Department of Revenue" and send with your return along with Form NC-EDU. Write the contribution amount on Form NC-EDU. Your election to contribute to the Fund cannot be changed after you file your return. Additional contributions to the Fund may be made by mailing your donation directly to the North Carolina Department of Public Instruction, Cash Collections, 6331 Mail Service Center, Raleigh, North Carolina 27699-6331. Make check payable to "North Carolina Department of Public Instruction" and indicate either on the check or in an attached note that it is a contribution for the North Carolina Education Endowment Fund. To designate your overpayment, see instructions for Line 19 below.

Line-by-Line Instructions

Line 1 - Enter on Line 1 the federal taxable income from Federal Form 1041, Line 22.

Line 2 - Additions to income - Determine the amount to enter on Line 2 by completing Schedule A, Lines 1 through 3, and allocating the additions between the beneficiaries and the fiduciary in Schedule B, Line 3. Enter on Line 2 the amount from Line 3, Fiduciary Column of Schedule B.

Line 4 - Deductions from income - Determine the amount to enter on Line 4 by completing Schedule A, Lines 4 through 10 and allocating the deductions between the beneficiaries and the fiduciary in Schedule B, Line 4. Enter on Page 1, Line 4 the amount from Line 4, Fiduciary Column of Schedule B.

Line 6 - If none of the federal taxable income, as adjusted (Line 5), is from dividends, interest, gains, losses, other intangibles, or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary, the total income of the estate or trust is taxable to the fiduciary and you should enter zero on Line 6. If there are nonresident beneficiaries and Line 5 includes any income from interest, dividends, gains, losses, other intangible property, or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary, enter the amount of such income for the benefit of nonresident beneficiaries on Line 6. The determination of the amount of federal taxable income (as adjusted) which is from intangible property or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary is based on the income beneficiary's state of residence on the last day of the taxable year of the estate or trust. In the case of both resident and nonresident income beneficiaries, the determination of the amount of federal taxable income (as adjusted) which is from intangible property or sources outside of North Carolina for the benefit of nonresidents is made on the basis that the nonresident beneficiaries' income interests for the taxable year relate to the income interests of both resident and nonresident income beneficiaries for the taxable year.

Line 9 - Complete Form D-407TC, Estates and Trusts Tax Credit Summary to determine the fiduciary's share of any tax credits. Enter on Line 9 the amount from Form D-407TC, Line 12.

Line 10 - If Form D-410P was filed to request an extension of time to file Form D-407, include any tax paid with the extension on Line 10.

Line 11 - No estimated tax is required of a fiduciary; however, if the fiduciary makes any prepayments of tax, include the prepayment on Line 11. If filing an amended return, include on this line any amount paid with the original return.

Line 12 - If tax was paid by a partnership or S corporation on behalf of the estate or trust, enter the amount paid and include with the return a copy of the information furnished by the partnership or S corporation to verify the payment. Also enter any North Carolina tax withheld that was reported on Form 1099R and include a copy of the form.

Line 15 - Enter the total penalties on Line 15a and interest due on Line 15b. [See (H) Penalties and interest above.] Add Lines 15a and 15b and enter the total on Line 15c.

Line 16 - Pay this Amount - Add lines 14 and 15c and enter the total. The total tax, penalties, and interest due must be paid by the fiduciary responsible for administering the estate or trust.

Line 18 - Contribution to the N. C. Nongame and Endangered Wildlife Fund - Help keep North Carolina wild by contributing any portion of your refund to the N. C. Nongame and Endangered Wildlife Fund. Your tax deductible contributions are essential to monitoring and managing our wildlife populations, including turtles, flying squirrels, frogs, mussels, salamanders, and hundreds of bird species from terns and pelicans to woodpeckers and warblers. Conserving these species and their habitats is important to our state, our economy, and our quality of life. If wildlife conservation is important to you, please give what you can and help conserve North Carolina's wildlife for future generations to enjoy.

If you wish to contribute to the Fund, enter the amount of your contribution on

Line 18. Your election to contribute to the Fund cannot be changed after you file your return. If you are not due a refund, you may still contribute to this Fund by donating online or mailing your donation directly to the North Carolina Wildlife Resources Commission, 1702 Mail Service Center, Raleigh, North Carolina 27699-1702. Checks should be made payable to the Nongame and Endangered Wildlife Fund. For more information about the Fund or to donate online, check out www.ncwildlife.org/give.

Line 19 - Contribution of overpayment to the N. C. Education Endowment Fund - If you wish to contribute all of part of your refund to the N. C. Education Endowment Fund, enter the amount of your contribution on Line 19. Your election to contribute to the Fund cannot be changed after you file your return.

Schedule A - North Carolina Fiduciary Adjustments

Schedule A is provided for the computation of the North Carolina fiduciary adjustments. The following additions and deductions are required by North Carolina law as adjustments to the income of the estate or trust.

Generally, estates and trusts are subject to the same additions and deductions allowed to individuals; therefore, see the North Carolina Individual Income Tax Instructions for a more detailed explanation of any applicable adjustments.

Additions to income, to the extent the amounts are not included in income:

Line 1 - Enter on Line 1 any interest received from bonds or obligations of a state or its political subdivisions other than North Carolina if not included in income.

Line 2 - Enter on Line 2 any other additions required.

Line 3 - Enter the total of Lines 1 and 2 on Line 3. The total additions should be apportioned between the beneficiaries and the fiduciary on Schedule B, Line 3.

Deductions from income, to the extent the amounts are included in income:

Line 4 - Enter any interest income which was received from obligations of the United States or United States' possessions.

Line 5 - Enter the taxable portion of any Social Security or Railroad Retirement benefits included in income.

Line 6 - Enter on Line 6 retirement benefits received from vested N. C. State government, N. C. local government, or federal government retirees. As a result of the North Carolina Supreme Court's decision in **Bailey v. State of North Carolina**, North Carolina may not tax certain retirement benefits received by retirees (and their beneficiaries and estates) of the State of North Carolina and its local governments or by United States government retirees (and their beneficiaries and estates), including military retirees. The exclusion applies to retirement benefits received from certain defined benefit plans, such as the North Carolina Teachers' and State Employees' Retirement System, the North Carolina Local Governmental Employees' Retirement System, the North Carolina Consolidated Judicial Retirement System, the Federal Employees' Retirement System, or the United States Civil Service Retirement System, if the retiree had five or more years of creditable service as of August 12, 1989. The exclusion also applies to retirement benefits received from the State's §401(k) and §457 plans if the retiree had contributed or contracted to contribute to the plan prior to August 12, 1989. **This exclusion does not apply to local government §457 plans or to §403(b) annuity plans.** Benefits from other State, local, and federal retirement plans may or may not be excluded depending on rulings in the **Bailey case**. The exclusion does not apply to retirement benefits paid to former teachers and state employees of other states and their political subdivisions. An estate entitled to exclude retirement benefits from North Carolina income tax should claim a deduction on Line 6 for the amount of excludable retirement benefits included in federal taxable income. A copy of Form 1099-R received from the payer must be attached to the return to support the deduction.

Line 7 - Enter any state, local, or foreign income tax refund that was included in income.

Line 8 - North Carolina law did not adopt the 50 percent bonus depreciation provisions in IRC section 168(k) for the tax year 2008 or in IRC sections 168(k) or 168(n) for tax years 2009 and 2010. Similarly, North Carolina did not adopt the provisions of the **Small Business Jobs Act of 2010** which extended the 50 percent bonus depreciation through 2011 and the **Tax Relief Act of 2010** which doubled and extended bonus depreciation from 50 percent to 100 percent for qualified property acquired and placed in service after September 8, 2010 and before January 1, 2012. The **Tax Relief Act of 2010** also provides 50% bonus depreciation for qualified property placed in service after December 31, 2011 and before January 1, 2013. Certain long-lived property and transportation property is eligible for 100% expensing if placed in service before January 1, 2013. Because North Carolina did not adopt the bonus depreciation provisions under IRC sections 168(k) and 168(n) of these Acts, an adjustment is required to add to income 85% of the amount deducted. Any amount added to income on the 2009, 2010, 2011, 2012, and 2013 State returns may be deducted in five equal installments beginning with the 2010, 2011, 2012, 2013, and 2014 State returns, respectively. Therefore, enter 20 percent of the bonus depreciation added back on the 2009, 2010, 2011, 2012, and 2013 State returns.

Line 9 - Enter on Line 9 any other deductions required.

Line 10 - Enter the total of Line 4, 5, 6, 7, 8f, and 9 on Line 10. The total deductions on Line 10 should be apportioned between the beneficiaries and the fiduciary on Schedule B, Line 4.

Schedule B - Apportionment of Adjustments

In taxing estates and trusts, all income is taxable to the fiduciary or to the beneficiaries. The conduit rule for taxing estates and trusts is applicable for North Carolina income tax purposes. Under the conduit rules regardless of who is taxed, the income retains its same character as when received by the estate or trust. The additions and deductions to federal taxable income of an estate or trust must be apportioned between the estate or trust and the beneficiaries based on the distributions of income made during the taxable year. Unless the trust instrument or will creating the estate or trust specifically provides for the distribution of certain classes of income to different beneficiaries, the apportionment of additions and deductions to the beneficiaries is determined on the basis that each beneficiary's share of the income for regular tax purposes (from Schedule K-1, Federal Form 1041) relates to adjusted total income (from Line 17 of Federal Form 1041). If the trust instrument or will specifically provides for the distribution of certain classes of income to different beneficiaries, any addition or deduction directly attributable to a particular class of income must be apportioned to the beneficiary to which that class of income is distributed. In apportioning the adjustments, the income for regular tax purposes must be adjusted for distributions to the beneficiary which are not reflected in the amount on Line 7. The adjusted total income (Line 17 of Federal Form 1041) must be adjusted (1) to exclude classes of income that are not part of the distribution to the beneficiary; (2) to include classes of income that are a part of the distribution to the beneficiary but are not included on Line 17; and (3) by any deduction treated differently for State and federal tax purposes that adjusts federal taxable income (see additions and deductions, Line 1 through 11 of Schedule A). The fiduciary may elect to apportion the federal deduction for State income tax to the estate or trust except in cases where the beneficiary's total distribution from the estate or trust has not been included in his federal taxable income because it exceeded the estate's or trust's federal distributable net income. In such cases, the addition for State income tax must be apportioned to the beneficiary to the extent his distribution exceeds the amount included in federal taxable income because of the State income tax deduction. After apportioning the additions and deductions to the beneficiaries, the balance is apportioned to the fiduciary.

Enter the full name and identifying number of each beneficiary and determine the additions and deductions to be allowed to each beneficiary and to the fiduciary. Each beneficiary should be furnished a Schedule NC K-1 showing the applicable additions, deductions, tax credits, etc., to be reported on the beneficiary's North Carolina income tax return. A nonresident individual, in calculating the percentage of taxable income subject to North Carolina tax on Line 15 of Page 1 of the individual income tax return, must adjust his share of the income from North Carolina sources only by the additions and deductions attributable to the North Carolina income. The fiduciary's portion of the additions and deductions should be reported on Lines 2 and 4, respectively, on Page 1 of Form D-407.

Form D-407TC - Estates and Trusts Tax Credit Summary

The tax credit for income tax paid to another state or country must be allocated between the fiduciary and the beneficiaries. Part 5 of Form D-407TC must be completed to determine the tax credit allowable to the fiduciary; however, before Part 5 can be completed, gross income (from Line 9, Federal Form 1041) on which such tax was paid must be allocated between the fiduciary and the beneficiaries.

The fiduciary's share and each beneficiary's share of the gross income on which tax has been paid to another state or country and the amount of tax paid on the income is determined by the governing instrument and such amounts should be entered on Lines 3 and 4 of the fiduciary and beneficiary's columns in Part 5, Section A. After allocating to the beneficiaries, enter the fiduciary's share of gross income taxed in another state or country on Line 1, Part 5, Section B. Enter on Line 2 the fiduciary's share of gross income from Federal Form 1041, Line 9. Complete the remaining Lines in Part 5, Section B to determine the fiduciary's share of the tax credit.

All tax credits allowed to individuals are allowed to estates and trusts except for the tax credit for income taxes paid to other states by individuals and the tax credit for children.

Complete Form D-407TC, Estates and Trusts Tax Credit Summary, if the estate or trust claims any tax credits. Include the form when filing Form D-407. If additional tax credits are claimed, submit a separate schedule showing how the credits were determined and how they are allocated between the beneficiaries and the fiduciary.

Sunset for Tax Credits - **Effect on Future Installments and Carryforwards** - For tax year 2014, various tax credits have been repealed. Taxpayers that qualified for these tax credits may continue to take any remaining installments and carryforwards of those tax credits after the sunset date if the taxpayer continues to meet the statutory eligibility requirements for each particular tax credit.

For example, the Article 3J credit for creating jobs is repealed for business activities that occur on or after January 1, 2014. In tax year 2013, a taxpayer, which met all eligibility requirements set out in N.C. Gen. Stat. § 105-129.83 and satisfied the threshold requirement for job creation, creates jobs in this State. The taxpayer claimed the jobs credit by filing Form NC-478A (the applicable NC-478 series form) and by paying the fee of $500.00 with the 2013 tax return on April 15, 2014. The taxpayer is allowed to take the first installment of the 2013 jobs credit on its 2014 tax return. Any unused portion of the first installment may be carried forward for the succeeding five years. The taxpayer is allowed to continue to take remaining installments as long as the taxpayer continues to meet the requirements of N.C. Gen. Stat. § 105-129.83 and N.C. Gen. Stat. § 105-129.87. If the taxpayer fails to maintain eligibility requirements, remaining installments are forfeited and only the carryforward amount of a previously accrued installment may be taken, subject to the carryforward provisions of N.C. Gen. Stat. § 105-129.84.