

GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003

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SENATE BILL 1217

Short Title: Modify Franchise Tax Loophole.

(Public)

Sponsors: Senators Clodfelter, Kerr, Dalton, Hartsell, Hoyle, Webster; and Foxx.

Referred to: Finance.

May 20, 2004

1 A BILL TO BE ENTITLED  
2 AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO  
3 CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE  
4 PROVISIONS THAT COULD RESULT IN FRANCHISE TAXES ON ASSETS  
5 NOT INDIRECTLY OWNED BY CORPORATIONS.

6 The General Assembly of North Carolina enacts:

7 SECTION 1. G.S. 105-114.1 reads as rewritten:

8 "§ 105-114.1. Limited liability companies.

9 (a) Definitions. – ~~The definitions in G.S. 105-130.7A apply in this section. In~~  
10 ~~addition, the following definitions apply in this section:~~

11 (1) Affiliated group. – Defined in section 1504 of the Code.

12 (2) Capital interest. – The right under a limited liability company's  
13 governing law to receive a percentage of the company's assets upon  
14 dissolution after payments to creditors.

15 (3) Entity. – A person that is not a human being.

16 (4) Governing law. – A limited liability company's governing law is  
17 determined under G.S. 57C-6-05 or G.S. 57C-7-01, as applicable.

18 ~~(2) Owned indirectly. – A person owns indirectly assets of a limited~~  
19 ~~liability company if the limited liability company's governing law~~  
20 ~~provides that seventy percent (70%) or more of its assets, after~~  
21 ~~payments to creditors, must be distributed upon dissolution to the~~  
22 ~~person as of the last day of the principal corporation's taxable year.~~

23 ~~(3) Principal corporation. – A corporation that is a member of a limited~~  
24 ~~liability company or has a related member that is a member of a limited~~  
25 ~~liability company.~~

26 (b) Controlled Companies. – If a corporation or an affiliated group of  
27 corporations owns seventy percent (70%) or more of the capital interests in a limited  
28 liability company, the corporation or group of corporations must include in its three tax  
29 bases under this Article the same percentage of the limited liability company's net

1 ~~assets. a related member of the corporation is a member of a limited liability company~~  
2 ~~and the principal corporation and any related members of the principal corporation~~  
3 ~~together own indirectly seventy percent (70%) or more of the limited liability~~  
4 ~~company's assets, then the following provisions apply:~~

5 (1) ~~A percentage of the limited liability company's income, assets,~~  
6 ~~liabilities, and equity is attributed to that principal corporation and~~  
7 ~~must be included in the principal corporation's computation of tax~~  
8 ~~under this Article.~~

9 (2) ~~The principal corporation's investment in the limited liability company~~  
10 ~~is not included in the principal corporation's computation of tax under~~  
11 ~~this Article.~~

12 (3) ~~The attributable percentage is equal to the percentage of the limited~~  
13 ~~liability company's assets owned indirectly by the principal~~  
14 ~~corporation divided by the percentage of the limited liability~~  
15 ~~company's assets owned indirectly by related members of the principal~~  
16 ~~corporation that are corporations.~~

17 (c) Constructive Ownership. – Ownership of the capital interests in a limited  
18 liability company is determined by reference to the constructive ownership rules for  
19 partnerships, estates, and trusts in section 318(a)(2)(A) and (B) of the Code with the  
20 following modifications:

21 (1) The term 'capital interest' is substituted for 'stock' each place it  
22 appears.

23 (2) A limited liability company and any noncorporate entity other than a  
24 partnership, estate, or trust is treated as a partnership.

25 (3) The operating rule of section 318(a)(5) of the Code applies without  
26 regard to section 318(a)(5)(C).

27 ~~Other Companies.~~ – ~~In all other cases, none of the limited liability company's~~  
28 ~~income, assets, liabilities, or equity is attributed to a principal corporation under this~~  
29 ~~Article.~~

30 (d) No Double Inclusion. – If a corporation is required to include a percentage of  
31 a limited liability company's assets in its tax bases under this Article pursuant to  
32 subsection (b) of this section, its investment in the limited liability company is not  
33 included in its computation of capital stock base under G.S. 105-122(b).

34 (e) Affiliated Group. – If the owner of the capital interests in a limited liability  
35 company is an affiliated group of corporations, the percentage to be included pursuant  
36 to subsection (b) of this section by each group member that is doing business in this  
37 State is determined by multiplying the capital interests in the limited liability company  
38 owned by the affiliated group by a fraction. The numerator of the fraction is the capital  
39 interests in the limited liability company owned by the group member, and the  
40 denominator of the fraction is the capital interests in the limited liability company  
41 owned by all group members that are doing business in this State.

42 (f) Exemption. – This section does not apply to assets owned by a limited  
43 liability company if the total book value of the limited liability company's assets never  
44 exceeded one hundred fifty thousand dollars (\$150,000) during its taxable year.

1       (g) Timing. – Ownership of the capital interests in a limited liability company is  
2 determined as of the last day of its taxable year. The adjustments pursuant to  
3 subsections (b) and (d) of this section must be made to the owner's next following return  
4 filed under this Article. If a limited liability company and a corporation or an affiliated  
5 group of corporations have engaged in a pattern of transferring assets between them  
6 with the result that each did not own the capital interests on the last day of its taxable  
7 year, the ownership of the capital interests in the limited liability company must be  
8 determined as of the last day of the corporation or group of corporations' taxable year.

9       (h) Penalty. – A taxpayer who, because of fraud with intent to evade tax,  
10 underpays the tax under this Article on assets attributable to it under this section is  
11 guilty of a Class H felony in accordance with G.S. 105-236(7)."

12       **SECTION 2.** G.S. 105-114.1(b), as amended by this act, reads as rewritten:

13       "(b) Controlled Companies. – If a corporation or an affiliated group of  
14 corporations owns ~~seventy percent (70%) or more~~ more than fifty percent (50%) of the  
15 capital interests in a limited liability company, the corporation or group of corporations  
16 must include in its three tax bases under this Article the same percentage of the limited  
17 liability company's net assets."

18       **SECTION 3.** Section 1 of this act becomes effective January 1, 2003, and  
19 applies to taxes due on or after that date. Section 2 of this act becomes effective January  
20 1, 2005, and applies to taxes due on or after that date. The remainder of this act is  
21 effective when it becomes law.