

**GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2005**

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**SENATE BILL 540
Finance Committee Substitute Adopted 3/30/05**

Short Title: Franchise Tax Loophole Closing.

(Public)

Sponsors:

Referred to:

March 15, 2005

A BILL TO BE ENTITLED

AN ACT TO APPLY THE FRANCHISE TAX TO CERTAIN LIMITED LIABILITY COMPANIES.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-114(b)(2) reads as rewritten:

"(b) Definitions. – The following definitions apply in this Article:

(1) City. – Defined in G.S. 105-228.90.

(1a) Code. – Defined in G.S. 105-228.90.

(2) Corporation. – A domestic corporation, a foreign corporation, an electric membership corporation organized under Chapter 117 of the General Statutes or doing business in this State, or an association that is organized for pecuniary gain, has capital stock represented by shares, whether with or without par value, and has privileges not possessed by individuals or partnerships. The term includes a mutual or capital stock savings and loan association or building and loan association chartered under the laws of any state or of the United States. The term includes a limited liability company that elects to be taxed as a C corporation under the Code, but does not otherwise include a limited liability company.

(3) Doing business. – Each and every act, power, or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges granted by the laws of this State.

(4) Income year. – Defined in G.S. 105-130.2(5)."

SECTION 2. G.S. 105-114.1 reads as rewritten:

"§ 105-114.1. Limited liability companies.

(a) Definitions. – The following definitions apply in this section:

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

- 1 (2) Capital interest. – The right under a limited liability company's
2 governing law to receive a percentage of the company's assets upon
3 dissolution after payments to creditors.
- 4 (3) Entity. – A person that is not a human being.
- 5 (4) Governing law. – A limited liability company's governing law is
6 determined under G.S. 57C-6-05 or G.S. 57C-7-01, as applicable.
- 7 (5) Noncorporate limited liability company. – A limited liability company
8 that does not elect to be taxed as a C corporation under the Code.

9 (b) Controlled Companies. – If a corporation or an affiliated group of
10 corporations owns more than fifty percent (50%) of the capital interests in a
11 noncorporate limited liability company, the corporation or group of corporations must
12 include in its three tax bases pursuant to G.S. 105-122 the same percentage of (i) the
13 noncorporate limited liability company's capital stock, surplus, and undivided profits;
14 (ii) fifty-five percent (55%) of the noncorporate limited liability company's appraised ad
15 valorem tax value of property; and (iii) the noncorporate limited liability company's
16 actual investment in tangible property in this State, as appropriate.

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

- 21 (1) The term "capital interest" is substituted for "stock" each place it
22 appears.
- 23 (2) A noncorporate limited liability company and any noncorporate entity
24 other than a 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 (d) No Double Inclusion. – If a corporation is required to include a percentage of
28 a noncorporate limited liability company's assets in its tax bases under this Article
29 pursuant to subsection (b) of this section, its investment in the noncorporate limited
30 liability company is not included in its computation of capital stock base under
31 G.S. 105-122(b).

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

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

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

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

13 **SECTION 3.** Article 3 of Chapter 105 is amended by adding a new section
14 to read:

15 "**§ 105-122.1. Credit for additional annual report fees paid by limited liability**
16 **companies subject to franchise tax.**

17 A limited liability company subject to tax under this Article is allowed a credit
18 against the tax imposed by this Article equal to the difference between the annual report
19 fee for corporations under G.S. 55-1-22 and the annual report fee for limited liability
20 companies under G.S. 57C-1-22(a). The credit allowed by this section may not exceed
21 the amount of tax imposed by this Article for the taxable year reduced by the sum of all
22 credits allowed, except payments of tax made by or on behalf of the taxpayer."

23 **SECTION 4.** This act is effective for taxable years beginning on or after
24 January 1, 2006.