



HOUSE BILL 619: Forced Combinations

2011-2012 General Assembly

Committee:	House Finance	Date:	June 17, 2011
Introduced by:	Reps. Howard, McLawhorn, Carney, Ingle	Prepared by:	Cindy Avrette & Dan Ettefagh
Analysis of:	Third Edition, with 4 unengrossed amendments		Committee Counsel

BILL SUMMARY: *House Bill 619 is before House Finance for a recommendation on whether or not the House should concur in the Senate Finance Committee Substitute, as amended. The Senate removed the contents of House Bill 619, which were ultimately included in the budget (S.L. 2011-145) and replaced them with provisions that change the Secretary of Revenue's authority to adjust the income of a multistate corporation or require it to file a combined return when the Secretary determines that the corporation conducts its business in a way that fails to accurately reflect its income attributable to North Carolina.*

The bill would become effective January 1, 2012, and apply to proposed assessments for taxable years beginning on or after January 1, 2012. The bill also provides that the provisions of the bill will be reviewed by the Revenue Laws Study Committee and it may recommend any changes needed to the law and may recommend whether the provisions of the new law should apply to pending assessments.

CURRENT LAW: Under current law, North Carolina is a single-entity filing state, meaning that a multistate corporation must determine its State net income as if it filed a separate return for federal income tax purposes. G.S. 105-130.14 prohibits a corporation from filing a consolidated or combined return in NC unless specifically directed by the Secretary to do so. Under G.S. 105-130.6, the Secretary can require a corporation to file a combined return with other parent, subsidiary, or affiliated corporations when the Department believes the corporation's net income attributable to this State is not accurately reflected on its separate filing return. After the Secretary directs, a corporation has 60 days to file a combined return before being subject to penalties if the taxpayer has not requested a hearing on the tax liability used as the basis for the penalty. The Secretary was directed in 2010 to adopt rules that describe when the Secretary would require the filing of a consolidated or combined return. A corporation must file a consolidated return when the rule adopted by the Department requires or, pursuant to a written request from the corporation, the Secretary provided written advice to the corporation stating that the Secretary will require a combined return. The Department has not adopted any rules in this area.

BILL ANALYSIS: House Bill 619 repeals G.S. 105-130.6 and replaces it with G.S. 105-130.5A, which provides the following:

- If the Secretary has reason to believe a corporation's business conduct causes it to inaccurately report net income attributable to its business in NC, the Secretary may give notice to and require any information necessary from the corporation to determine whether its intercompany transactions have economic substance¹ and are at FMV between affiliated members.² The corporation has 90 days to comply.

¹ Economic substance exists where transaction/s have both 1/+ reasonable business purposes AND economic effects, other than tax benefits. Reasonable business purposes and economic effects include any material benefit other than tax benefits that are not consistent with legislative intent. A showing that a transaction has economic effect beyond tax benefit may be satisfied by demonstrating material business activity of the entities involved. Centralized cash management of an affiliated

Research Division
O. Walker Reagan, Director
(919) 733-2578

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- If the Secretary reviews the provided information and finds as fact that the intercompany transactions lack economic substance or were not at FMV, the Secretary may redetermine the State net income of the corporation by (i) adjusting the intercompany transactions to accurately reflect State net income or (ii) requiring the corporation to file a combined return for all members of its affiliated group conducting a unitary business.³ If either option is utilized, the Secretary must provide the corporation with a written statement containing details of the rationale supporting the findings of fact as to inaccurate reporting and as to the Secretary's proposed computational method of income.
- If the Secretary finds as fact that a combined return is required, the Secretary may give written notice and require the submission of a combined return within 90 days of the notice. The submission does not act as an admission of liability, and the Secretary or corporation may propose a combination of fewer members.
- In determining whether transactions between members of the affiliated group of entities are at FMV, the Secretary must apply the standards contained in Section 482 of the Code.
- If a combined return is require, the combined net income of the corporation and affiliated members must be apportioned in a way that fairly reflects the current apportionment formula applicable to the corporation and each included affiliated member in determining State income tax.
- Properly required returns not timely submitted result in penalties.
- A corporation may request in writing specific advice regarding whether a redetermination of net income or a combined return would be required under listed facts, and the Secretary may request additional information to fulfill the request. Advice must be provided within 120 days of receipt of the request. The Secretary may charge a fee for providing advice, which are credited to an account in the Department and do not revert to the GF. The fee must be between \$100 and \$5000 unless waived by the Secretary.
- The Secretary may extend the time limits contained in G.S. 105-130.5A, by mutual agreement.
- Appeals of the Secretary's determination are to OAH, with the ALJ reviewing, de novo, (i) whether the separate income tax returns fail to report State net income property due to transactions that lack economic substance or are not of FMV between affiliated members, (ii) whether the Department's determination of net income is appropriate to properly determine State-attributable corporate income, and (iii) where a combined return is required, whether adjustments other than requiring the combined return are adequate to redetermine State net income.

EFFECTIVE DATE: The act becomes effective January 1, 2012, and applies to proposed assessments for taxable years beginning on or after January 1, 2012.

group, alone, is not evidence of an absence of economic substance, and a financial accounting benefit is not a reasonable business purpose, alone, if the origin is a reduction of income tax.

² An affiliated group is 2/+ corporations or noncorporate entities in which more than 50% of the voting stock/ownership interest of each member is directly or indirectly owned or controlled by a common owner or owners, excluding (i) corporations not required to file a federal income tax return; (ii) certain insurance companies; (iii) 501 tax-exempt corporations; (iv) S corporations; (v) foreign corporations under section 7701 of the Code; (vi) a partnership, LLC, or other entity not taxed as a corporation; and (vii) a corporation with at least 80% of its gross income from all sources in the tax from active foreign business income.

³ This authority exists even if all members of the affiliated group are not doing business in the State.

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