

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

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SENATE DRS65389-LCxz-178J (1/21)

Short Title: Modify Franchise Tax Loophole.

(Public)

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

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE PROVISIONS THAT COULD RESULT IN FRANCHISE TAXES ON ASSETS NOT INDIRECTLY OWNED BY CORPORATIONS.

The General Assembly of North Carolina enacts:

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

"§ 105-114.1. **Limited liability companies.**

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

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

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

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

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

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

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

(b) Controlled Companies. – If a corporation or an affiliated group of corporations owns seventy percent (70%) or more of the capital interests in a limited

1 liability company, the corporation or group of corporations must include in its three tax
2 bases under this Article the same percentage of the limited liability company's net
3 assets. a related member of the corporation is a member of a limited liability company
4 and the principal corporation and any related members of the principal corporation
5 together own indirectly seventy percent (70%) or more of the limited liability
6 company's assets, then the following provisions apply:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

21 **SECTION 3.** Section 1 of this act becomes effective January 1, 2003, and
22 applies to taxes due on or after that date. Section 2 of this act becomes effective January
23 1, 2005, and applies to taxes due on or after that date. The remainder of this act is
24 effective when it becomes law.