



MULTISTATE INCOME/FRANCHISE TAX

North Carolina enacts pass-through entity tax election Tax Alert

Overview

On November 18, 2021, the North Carolina governor signed [Senate Bill 105](#) (S.B. 105), which includes a new elective pass-through entity tax (“PET”). S.B. 105 allows pass-through entities, including entities taxed as a partnership or S corporation, to elect to pay an entity level state income tax for taxable years beginning on or after January 1, 2022. Correspondingly, in computing North Carolina taxable income, a partner or shareholder of an electing pass-through entity must deduct their pro rata share of income subject to the PET. Alternatively, in computing North Carolina taxable income, a partner or shareholder of an electing pass-through entity must add their pro rata share of loss subject to the PET.

This Tax Alert summarizes some of the provisions of the North Carolina pass-through entity tax election. Note that other relevant tax law changes in S.B. 105 are covered in the Tax Alert from November 30th available [here](#).

Summary of pass-through entity tax election

- Effective for taxable years beginning on or after January 1, 2022, partnerships or S corporations may elect to have income tax imposed at the entity level.
- The election cannot be made by a publicly traded partnership or a partnership that has at any time during the taxable year a partner who is not an individual, estate, a trust under Internal Revenue Code (“IRC”) section 1361(c)(2), or a tax exempt organization under IRC section 1361(c)(6).
- The election is made on a timely filed annual return. Once made, the election is irrevocable for that taxable year after the due date of the return, including extensions.
- Electing S corporations are not permitted to file a composite return and make composite payments of tax on behalf of its non-resident shareholders.
- The PET shall be computed at 4.99% of North Carolina taxable income, which is the individual income tax rate for taxable years beginning in 2022.

- North Carolina taxable income is equal to the sum of each partner's or shareholder's pro rata share of income or loss, subject to adjustments, attributable to North Carolina plus each resident partner's or shareholder's pro rata share of income or loss, subject to adjustments, not attributable to North Carolina.
- Electing pass-through entities must remit estimated payments in the same manner as C corporations if the estimated PET equals or exceeds \$500. For calendar year taxpayers, estimated tax payments are generally due on April 15th, June 15th, September 15th, and December 15th of the taxable year.
- In computing North Carolina taxable income, a partner or shareholder of an electing entity may deduct their share of income or add their share of loss to the extent it was included in the electing pass-through entity's North Carolina taxable income.
- Any credits allowed under North Carolina law for any taxable period the PET election is made and the carryforward of the unused portion of such credit shall not pass through to the electing pass-through entity's partners or shareholders.
- For purposes of allowing a credit for income taxes imposed and paid to another state or country on income taxed in North Carolina (i.e., resident partner's or shareholder's pro rata share of income or loss not attributable to North Carolina), an electing partnership or electing S corporation is allowed a credit against its North Carolina PET. As a result of the entity claiming the credit against the PET, resident individual partners or shareholders of electing pass-through entities are not allowed a credit for taxes paid to another state or country on income that is taxed to the electing pass-through entity.

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