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MULTISTATE INCOME/FRANCHISE TAX

North Carolina conforms to federal partnership audit regime and updates IRC conformity

Tax Alert

Overview

On July 2, 2026, North Carolina enacted Senate Bill 595 (“S.B. 595”), an omnibus taxation measure. Among other changes, S.B. 595 adopts a state framework for reporting federal partnership adjustments under the federal centralized partnership audit regime, updates North Carolina’s conformity to the Internal Revenue Code (“IRC”) from January 1, 2023, to July 5, 2025, following the One Big Beautiful Bill Act (“OBBBA”), and decouples from the federal treatment of domestic research and experimental expenditures. Except as otherwise provided below, S.B. 595 is effective when it became law.

This Tax Alert summarizes the state reporting of federal partnership adjustments and federal conformity provisions of S.B. 595.

Reporting federal partnership adjustments

S.B. 595 adds new North Carolina General Statutes (“N.C.G.S.”) section 105-154.2, establishing state reporting and payment procedures for federal partnership adjustments arising from partnership-level audits under the Bipartisan Budget Act of 2025 (“BBA”) and from administrative adjustment requests. North Carolina had not previously enacted statutes conforming to the BBA, and the new section generally follows the model statute issued by the Multistate Tax Commission.

Under the default reporting procedure in N.C.G.S. section 105-154.2(c), a partnership doing business in North Carolina must, within 90 days after a final federal partnership adjustment, file a return reflecting the adjustment and notify each direct partner of the partner’s distributive share, and each direct partner subject to tax must file a return and pay any additional tax within six months after the final federal partnership adjustment.

As an alternative, N.C.G.S. section 105-154.2(d) provides an election for an audited partnership to report and pay tax at the entity level. The election is irrevocable and requires the partnership to file its return, notify its tiered partners, and pay the amount determined under the section within six months after the final federal partnership adjustment. An amount properly reported and paid by the audited partnership is treated as paid in lieu of the tax owed by the direct and indirect partners on the same adjustment, and those partners are not permitted to take a deduction or credit for the amount or to claim a refund of it.

The election for the partnership to pay is unavailable if the partnership made the taxed partnership election under N.C.G.S. section 105-154.1(a) for the reviewed year, if the adjustment resulted from an administrative adjustment request, or if the partnership was not required to file an information return under N.C.G.S. section 105-154(c) because it was not doing business in North Carolina for the reviewed year.

Tiered partners and their owners or beneficiaries are subject to the reporting and payment requirements, and the tiered partners may make the partnership pays election.

The statute of limitations for proposing an assessment related to the reporting of final federal partnership adjustments if the return reporting the adjustments is timely filed is one year after such return is filed or three years after the original return was filed or due to be filed, whichever is later. If the taxpayer did not timely file the return to report the federal partnership adjustments, the period for proposing an assessment of any tax due is six years after the date the Secretary received the final report of the final federal partnership adjustment.

The statute of limitations for obtaining a refund related to the reporting of final federal partnership adjustments is one year after the return reflecting the final federal partnership adjustments is filed (assuming the return was timely filed) or three years after the original return was filed or due to be filed, whichever is later. This part applies to taxable years beginning on or after January 1, 2026, and applies to federal partnership adjustments that become final on or after that date.

IRC conformity

S.B. 595 amends the definition of "Code" in N.C.G.S. section 105-228.90(b)(7) to update the reference to the Internal Revenue Code from January 1, 2023, to July 5, 2025, following enactment of the OBBBA.

In connection with the updated conformity date, S.B. 595 decouples from the federal treatment of domestic research and experimental ("R&E") expenditures under IRC section 174A(a), as enacted by section 70302 of the OBBBA. S.B. 595 adds new N.C.G.S. section 105-130.5C for corporate income tax and new N.C.G.S. section 105-153.6A for individual income tax, each requiring a taxpayer that deducts domestic R&E expenditures under IRC section 174A(a) to add back 80 percent of the amount deducted for the taxable year, and allowing a deduction of 25 percent of the added back amount in each of the first four taxable years following the year of the add back. The adjustments do not result in a difference in the basis of the affected assets for state and federal income tax purposes.

The decoupling provisions apply to taxable years beginning on or after January 1, 2022, for taxpayers who elect for federal income tax purposes the retroactive application of IRC section 174A(a) for a taxable year beginning in 2022, 2023, or 2024, and to taxable years beginning on or after January 1, 2025, for taxpayers who do not make that election.

Other changes

In addition to the provisions discussed above, S.B. 595 includes several other changes, some of which are summarized here.

- Personal income tax changes: S.B. 595 confirms that the state net operating loss is available only to individuals, estates, and trusts and not to taxed passthrough entities, applicable retroactively to taxable years beginning on or after January 1, 2022, and provides that a federal excess business loss generates a state net operating loss carryforward for taxable years beginning on or after January 1, 2026. S.B. 595 rewrites N.C.G.S. section 105-160.2 to remove income tax on undistributed estate and trust income not sourced to the state, updates N.C.G.S. section 105-154.1(c) to allow certain taxed partnerships to pass through credits to partners, and extends the Hurricane Helene interest waiver through September 25, 2025.
- Corporate and franchise tax changes: S.B. 595 reorganizes the franchise tax rate provisions for C corporations and S corporations, adds a net worth deduction for an investment of more than 80 percent in an insurance company subject to the gross premiums tax applicable retroactively to taxable years

beginning on or after January 1, 2019, and establishes a credit equal to 40 percent of qualified rehabilitation expenditures of at least $10 million with respect to an eligible corporate campus for taxable years beginning on or after January 1, 2026. S.B. 595 also corrects the taxed S corporation language in G.S. 105-131.1(b) and removes an affiliated indebtedness net worth deduction applicable retroactively to taxable years beginning on or after January 1, 2021.

Get in touch

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