

North Carolina Opts-Out of Many of the Taxpayer Favorable Provisions of the CARES Act

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07.01.2020

In an effort to prevent further drain and strain on North Carolina's revenues Governor Roy Cooper signed H.B. 1080 (Sess. Law 2020-58) into law on June 30, 2020. The widely-supported bill allows North Carolina to opt-out or decouple from many of the taxpayer favorable provisions of the CARES Act (Pub. Law 116-136), while also addressing some sales and use tax issues and changes to tax procedures. This insight covers the highlights of H.B. 1080; a more detailed summary of each provision can be found [here](#). Nexsen Pruet's detailed coverage of the tax provisions in the CARES Act may be found [here](#).

Decoupled CARES Act Tax Provisions

Net Operating Losses

North Carolina decoupled from the modification made to the Net Operating Loss (NOL) rules in the CARES Act, which provide for a temporary five-year carryback period NOLs arising in calendar years 2018, 2019, and 2020 and allows NOLs for those calendar years to offset 100% of taxable income until the 2021 tax year. Instead, North Carolina will maintain the NOL rules mirroring those enacted by the Tax Cuts and Jobs Act of 2017 (Pub. Law 115-97), wherein NOLs only offset 80% of taxable income, cannot be carried back, but have an indefinite carryforward. This decision should protect the state's revenue by preventing an influx of refund claims to carryback NOLs as far as 2014.

Limitation on Deduction of Business Interest

H.B. 1080 opts-out of the CARES Act's temporary relaxation of the 30% adjusted taxable income (ATI) limitation on the business interest deduction. The CARES Act increased the ATI limit from 30% to 50% for 2019 and 2020, and allows a business to elect to use its 2019 ATI when computing its 2020 limitation. North Carolina is keeping this limitation at 30% and 2019 ATI cannot be used to compute the 2020 limitation. Again, this should prevent

an influx of refund claims and limit the opportunity for tax savings at the state level to protect revenues.

Charitable Contributions

The CARES Act made several adjustments concerning charitable contributions. For individuals that do not itemize their deductions, the CARES Act provides a new \$300 “above the line” deduction. For individual taxpayers that do itemize their deductions, the CARES Act temporarily raises the Adjusted Gross Income (AGI) limitations on charitable giving to public charities and donations from 60% to 100%. Excess contributions may be carried forward for five years. The limitation on corporate donors is increased from 10% of adjusted taxable income to 25%.

H.B. 1080 decouples the state from all of these taxpayer favorable adjustments to the charitable contribution rules, so there will be no \$300 above the line deduction at the state level and the AGI remains at 60% for individuals and 10% for corporations.

Income Exclusion for Employer Payments of Student Loans

The CARES Act provides an exclusion by permitting employers to pay up to \$5,250 in 2020 of an employee’s student loan obligations tax free. H.B. 1080 opts-out of this exclusion; thus these employer payments will be considered taxable income at the state level.

Notable Conformity – PPP Loans

While H.B. 1080 decouples from many taxpayer favorable CARES provisions, there are some areas of notable conformity addressed in the bill. Namely, H.B. 1080 specifies that to the extent a Paycheck Protection Program (PPP) loan is forgiven, it will be excluded from taxable income at the state level. For an in-depth discussion of PPP loan forgiveness, read this. However, the state will also follow the current position of the IRS and require the add back of any PPP loan expenses if the payment of those expenses results in forgiveness of the PPP loan.

This add back to income is designed to prevent a double tax benefit, i.e., receiving a deduction for expenses paid with income that is ultimately exempt from tax. This is similar to the position the IRS has taken in Notice 2020-32. For more details on Notice 2020-32, read this.

Sales and Use Tax Updates

H.B. 1080 includes three significant sales and use tax updates. First, it clarifies the economic nexus threshold (200 transaction or gross sales in excess of \$100,000) applies only to remote marketplace facilitators. This makes sense because marketplace facilitators with a physical presence in North Carolina were already required to collect and remit sales tax on the first dollar of North Carolina sales. Second, it specifies digital code is taxed in the same manner as the digital property for which the digital code relates – sorry software developers. Finally, it mandates food delivery services acting as marketplace facilitators, like UberEats, GrubHub, DoorDash, Postmates, etc., have to collect and remit sales taxes and local meal taxes.

Takeaways

While North Carolina traditionally decouples from a handful of Federal tax provisions every year, the decision to decouple from many of the taxpayer favorable CARES Act provisions will create a larger variance between Federal and state tax returns than prior years. Despite the increased administrative inconvenience on taxpayers, the North Carolina Legislature is clearly hoping these measures will reduce or prevent further drain and strain on the state's revenue. To end, the clarifications and updates to the sales and use tax provisions are indicative of a largely nation-wide trend of expanding the scope and base of sale and use taxes. The Legislature is hoping the sales and use tax updates will increase state revenues.

Keep checking for updates and additional Insights here. For more detailed information and guidance please reach-out to David M. McCallum and your Nexsen Pruet Tax Team.