17 NCAC 06B .0117 TRANSITIONAL ADJUSTMENTS

(a) The additions required by G.S. 105-134.7(a)(1) include the increase in basis by the amount of federal gift tax paid on property received as a gift and any expenditures for interest and taxes capitalized for federal income tax purposes.

(b) The deductions allowed by G.S. 105-134.7(a)(2) include the increase in basis by the amount of State gift tax paid on property received as a gift and any business expenditures that an individual elected to expense under Section 179 of the Internal Revenue Code but which were required to be capitalized for State income tax purposes.

(c) If, for a tax year beginning on or after January 1, 1989, a taxpayer has both a net economic loss carried forward from a tax year beginning before January 1, 1989, and a federal net operating loss carried back from a future year, the net operating loss is considered a business-connected deduction in determining the amount of net economic loss deducted in that year pursuant to G.S. 105-134.7(a)(4).

(d) The additions required by G.S. 105-134.7(a)(6) include capital losses, charitable contributions, passive losses, and net operating losses incurred in taxable years beginning prior to January 1, 1989, and carried over for federal income tax purposes to taxable years beginning on or after January 1, 1989.

In determining the amount of a capital loss to add back, short-term capital losses from taxable years beginning prior to January 1, 1989, must be applied before applying short-term capital losses incurred in taxable years beginning on or after January 1, 1989, and before applying long-term capital losses from any year. Long-term capital losses from taxable years beginning prior to January 1, 1989, must be applied before applying long-term capital losses incurred in taxable years beginning on or after January 1, 1989.

(e) Other adjustments required by G.S. 105-134.7(b) include the difference in the amount of contributions to an annuity recovered, a child's unearned income reported by the child's parent, reforestation expenses, and a lump sum distribution received as a result of the class action in Simpson v. N.C. Local Government Employees' Retirement System as follows:

(1) An individual who recovered all or any portion of the individual's contributions to an annuity for State income tax purposes for taxable years beginning prior to January 1, 1989, but did not recover the amount for federal income tax purposes must include a ratable portion of the difference in the cost previously recovered for North Carolina purposes and the amount previously recovered for federal purposes on the North Carolina return for each year beginning on or after January 1, 1989. The ratable portion to be added to federal taxable income is determined as follows:

$$\frac{\text{Amount recovered on State return} - \text{Amount recovered on Federal return}}{\text{Remaining Years Life Expectancy}} = \text{Addition to Taxable Income}$$

If the cost recovered for federal income tax purposes for taxable years beginning prior to January 1, 1989, is greater than the cost recovered for State income tax purposes for years prior to 1989, the ratable portion to be deducted from federal taxable income is determined as follows:

$$\frac{\text{Amount recovered on Federal return} - \text{Amount recovered on State return}}{\text{Remaining Years Life Expectancy}} = \text{Deduction from Taxable Income}$$

The amount of difference in the numerator of the fractions in this Subparagraph must reflect the cost recovered during the taxpayer's period of residence in North Carolina and exclude any cost recovered during residence in another state. In the denominator, the remaining years life expectancy to be entered is the life expectancy determined for federal income tax purposes for the year the annuity started less the number of tax years the annuity was reportable for federal tax purposes prior to January 1, 1989. The amount of the transitional adjustment computed for the tax year 1989 must remain the same for each year of the individual's remaining life expectancy.

This transitional adjustment does not apply to retirement annuities that were exempt under prior State law, including retirement annuities from the North Carolina Teachers' and State Employees' Retirement System and the North Carolina Local Governmental Employees' Retirement System. Also, this transitional adjustment does not apply to retirement annuities that were received by former teachers and state employees of other states and were fully exempt from North Carolina income tax prior to January 1, 1989, because the other state had no income tax law or practiced reciprocity with North Carolina with respect to taxing these benefits.

This transitional adjustment applies to retirement annuities that were received by former teachers and state employees of other states and were not fully exempt because those states practiced no reciprocity or only partial reciprocity with North Carolina with respect to these benefits for taxable years beginning prior to January 1, 1989. The amount of cost recovered on the North Carolina return prior to January 1, 1989, to be used in the formula for computing the addition to federal taxable income must be computed without considering any benefits that were excluded as the result of partial reciprocity.

(This adjustment applies to a retirement annuity from any federal retirement program. The adjustment is determined as of January 1, 1989, but applies only to tax years beginning on or after January 1, 1992.)

(2) A parent electing to report a child's unearned income for federal tax purposes must add back to the parent's federal taxable income the amount of the child's unearned income in excess of five hundred dollars ($500.00), with the limitation that the amount added back is not to exceed the amount of the child's unearned income that is not taxed at the parent's marginal rate for federal tax purposes.

(3) A taxpayer who elects to claim reforestation expenses currently on the taxpayer's North Carolina tax return for tax years beginning prior to January 1, 1989, must add to federal taxable income the amount deducted as amortization expenses each year for federal tax purposes. A taxpayer who amortized these expenses on the taxpayer's North Carolina return for tax years beginning prior to January 1, 1989, may continue to amortize by deducting the allowable amortization expenses each year on the North Carolina return; however, federal taxable income must be increased by the amortization expenses claimed each year for federal tax purposes.

(4) As a result of the class action in Simpson v. N.C. Local Government Employees' Retirement System, certain members of the retirement system received a lump sum distribution in 1991 representing disability compensation benefits that should have been paid in prior years. The portion of the distribution that is attributable to tax years prior to 1989 shall be deducted from federal taxable income on the 1991 return. The portion of the proceeds attributable to 1989 and 1990 is taxable in 1991 to the extent it exceeds the four thousand dollar ($4,000) retirement exclusion provided under G.S. 105-134.6(b)(6)a.

History Note: *Authority G.S. 105-134.7; 105-262; 105-264;*
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