



# SENATE BILL 99: Appropriations Act of 2018, Sec. 38.1: IRC Update

2017-2018 General Assembly

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<b>Committee:</b>		<b>Date:</b>	July 10, 2018
<b>Introduced by:</b>		<b>Prepared by:</b>	Cindy Avrette
<b>Analysis of:</b>	Sec. 38.1 of S.L. 2018-5		Staff Attorney

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**OVERVIEW:** *Sec. 38.1 of S.L. 2018-5 updates the reference to the Internal Revenue Code (IRC) from January 1, 2017, to February 9, 2018. Therefore, to the extent North Carolina follows federal tax provisions in calculating State tax liability, changes made to the IRC by the federal Tax Cuts and Jobs Act (TCJA) and the Bipartisan Budget Act of 2018 (Budget Act) will apply to North Carolina.*

*This act conforms to all of the various tax law changes made by Congress in the TCJA, except as provided below:*

- *The act decouples from the deferral of gain and the exclusion of gain for assets invested in an Opportunity Fund.*
- *The act decouples from the inclusion and deduction associated with foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI).*

*The Budget Act temporarily reduces the threshold for deducting medical expenses from 10% to 7.5% of income for the 2017 and 2018 taxable years, and this section conforms to this change. The Budget Act also extends three provisions from which North Carolina has historically decoupled; this section continues to decouple from those three provisions: (i) income exclusion for forgiveness of debt on primary residence; (ii) mortgage insurance deductible as mortgage interest; and (iii) deduction for tuition and expenses.*

*This section has various effective dates. Please see the full summary for more detail.*

## CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

The TCJA made many changes to the calculation of federal taxable income. This legislation's impact on North Carolina is not as significant as it may be on other states due to the tax reform changes enacted in this State since 2011. For additional information, see [Federal Tax Reform and Its Impact on NC Revenues](#). This section decouples from two of the tax changes included in TCJA: (i) the deferral of gain and the exclusion of gain for assets invested in an Opportunity Fund; and (ii) the inclusion, and deduction, associated with foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI).

The Budget Act temporarily reduces the threshold for deducting medical expenses from 10% to 7.5% of income for the 2017 and 2018 taxable years. This section conforms to this change. This section decouples from three provisions extended in the act: (i) income exclusion for forgiveness of debt on primary residence; (ii) mortgage insurance deductible as mortgage interest; and (iii) deduction for tuition and expenses.<sup>1</sup> For an additional listing of provisions being conformed to, but that have minimal fiscal impact, see [IRC Update Provisions](#).

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<sup>1</sup> North Carolina has historically decoupled from these three provisions.



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Except as otherwise noted in the chart below, this section became effective when the act became law on June 12, 2018, and the changes are applicable to North Carolina's tax law in the same manner as applied for federal tax purposes. For information concerning the fiscal impact of this section, please see: [Fiscal memorandum](#) and [Fiscal memorandum chart](#).

Here is a section-by-section analysis of Section 38.1:

Subsection	Explanation	Effective Date
(a)	Changes the IRC reference from January 1, 2017, to February 9, 2018.	June 12, 2018
(b)	Makes the adjustments necessary to State net income to decouple from the recently enacted FDII, GILTI, and Opportunity Zone provisions.	June 12, 2018
(c)	Makes the adjustments necessary to North Carolina taxable income to decouple from the recently extended provisions in the Bipartisan Budget Act of 2018 and from the Opportunity Zone provisions. It also removes language that would otherwise prohibit an individual taxpayer from claiming a State itemized deduction if the taxpayer claimed the federal standard deduction; this change is necessary since the federal standard deduction amount is currently greater than the State standard deduction amount. <sup>2</sup>	June 12, 2018
(d)	Removes unnecessary language in the definition of "wages."	June 12, 2018
(e) & (f)	Repeals an addback for a Section 199 deduction taken at the federal level. Section 199 of the Code is the domestic production activities deduction. North Carolina decoupled from this federal deduction in 2005. The State addback is being repealed because the federal deduction was repealed in the TCJA. <sup>3</sup>  For taxable years beginning on or after January 1, 2018.	For taxable years beginning on or after January 1, 2018.
(g)	Decouples North Carolina's filing requirement from the federal filing requirement. Under current law, an individual's obligation to file a State income tax return is tied to whether the individual had to file a federal return. An individual is required to file a federal income tax return if the individual's gross income exceeds the federal standard deduction. Since the federal standard deduction is now higher than the North Carolina standard deduction, taxpayers with income less than the federal standard deduction amount but more than the North Carolina standard deduction amount would not be required to file a North Carolina tax return although North Carolina income tax may be due. This change corrects this problem.	June 12, 2018
(h) & (i)	Enables participants in the NC 529 Plan to take full advantage of the expanded benefits permitted under section 529 of the Code, as amended by the TCJA. Under the TCJA changes enacted by	Subsection (h) applies to taxable years

<sup>2</sup> The 2018 federal standard deduction amount, for married filing jointly, is \$24,000. The 2018 State standard deduction amount, for married filing jointly, is \$17,500. The State standard deduction amount will increase to \$20,000 for the 2019 taxable year.

<sup>3</sup> Section 13305 of P.L. 115-97.

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	<p>Congress, a participant in a 529 Plan may withdraw funds to pay for tuition in connection with a beneficiary's enrollment at an elementary or secondary public, private, or religious school. Previously, a withdrawal could only be made for purposes of higher education expenses. The TCJA also allows existing 529 savings plans to be rolled into 529 ABLE accounts.</p> <p>Under federal law, contributions to a 529 Plan are payable from after-tax income but the earnings in a 529 Plan are not taxable and will not be taxed when the money is withdrawn for purposes permitted under section 529 of the Code. The tax-free nature of the earnings is also applicable for State tax purposes because North Carolina follows federal law. Prior to taxable years beginning on or after January 1, 2014, contributions to a NC 529 Plan were tax deductible for State tax purposes. If funds are withdrawn from the Plan and not used for qualified higher education expenses, then the taxpayer must add the amount deducted in a prior taxable year to the taxpayer's State taxable income in the year the funds are withdrawn.</p> <p>Subsection (h) makes conforming changes to the income tax add-back provision to avoid penalizing a taxpayer who took the income tax deduction for contributions to the NC 529 Plan while the deduction was in effect when the person withdraws the funds for purposes allowed under section 529 of the Code, as amended by Congress in the TCJA.</p> <p>Subsection (h) applies to taxable years beginning on and after January 1, 2018.</p> <p>Subsection (i) makes conforming changes to the Parental Savings Trust Fund established under G.S. 116-209.25 and the responsibilities of the State Education Assistance Authority (SEAA) for the fund. The SEAA provides the requisite State oversight for the NC 529 Plan to be operated as a "qualified tuition program" under the IRC.</p> <p>Subsection (i) became effective June 12, 2018.</p>	beginning on or after January 1, 2018. Subsection (i) became effective June 12, 2018.
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