

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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HOUSE BILL 1477

Short Title: Conform Bank Tax to Federal.

(Public)

Sponsors: Representative Miller.

Referred to: Finance.

May 13, 1999

A BILL TO BE ENTITLED

**AN ACT TO CONFORM STATE INCOME TAX ON BANKS TO FEDERAL
INCOME TAX ON BANKS.**

The General Assembly of North Carolina enacts:

Section 1. The General Assembly finds that:

- (1) Federal income tax law generally does not allow corporations to deduct interest expenses incurred in producing tax-exempt income.
- (2) State corporate income tax law also provides that interest paid in connection with tax-exempt income is not deductible.
- (3) Until 1986, federal tax law was interpreted to exempt banks from this rule, because their interest expenses on deposits were not considered directly related to the purchase of tax-exempt bonds with the deposited funds.
- (4) Since 1986, however, federal law no longer allows banks to deduct interest expenses allocable to purchasing tax-exempt bonds, except for interest expenses allocable to bonds issued by small local government units.
- (5) Although the federal law has changed, North Carolina's law has been interpreted to be the same as the pre-1986 federal law: banks do not

1 have to follow the general rule that prohibits corporations from
2 deducting interest paid in connection with tax-exempt income.

3 (6) Thus, corporations engaged in the banking business get a State tax
4 deduction that is not allowed to other corporations under State or federal
5 law, and is not allowed to banks under federal law.

6 (7) Section 2 of this act amends North Carolina income tax law to provide
7 that banks are taxed in the same manner as under federal law and will
8 no longer get a tax deduction that is not allowed to other corporations.

9 Section 2. G.S. 105-130.5(a) is amended by adding a new subdivision to read:

10 "(2a) That portion of a financial institution's interest expense that is allocable
11 to interest income exempt from taxation under this Division. The
12 allocable portion of the interest expense is the portion for which
13 deduction would be disallowed pursuant to section 265(b) of the Code if
14 the interest were earned on a tax-exempt obligation as defined in section
15 265(b) of the Code."

16 Section 3. Notwithstanding G.S. 105-163.41, no addition to tax may be made
17 under that statute for a taxable year beginning on or after January 1, 1999, and before
18 January 1, 2000, with respect to an underpayment of corporation income tax to the extent
19 the underpayment was created or increased by this act.

20 Section 4. This act is effective for taxable years beginning on or after January
21 1, 1999.