Bill Draft 2017-BAx-16: Various Changes To The Revenue Laws.

2017-2018 General Assembly

Committee:	Revenue Laws Study Committee	**Date:**	April 11, 2018
Introduced by:		**Prepared by:**	Finance Team
Analysis of:	2017-BAx-16		

OVERVIEW: This bill draft would make various technical, clarifying, and administrative changes to the Revenue Laws, many of which have been recommended by the Department of Revenue.

Section	Bill Analysis	Effective Date[1]
	PART I. IRC UPDATE	
1.1	Updates the reference to the Internal Revenue Code from January 1, 2017, to February 9, 2018. Except as provided below, this means that 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 will apply to North Carolina. 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. Here are some of the major tax reform changes North Carolina has enacted that minimize the impact of the TCJA: • NC starts with adjusted gross income instead of federal taxable income. • NC does not conform to federal standard deductions or personal exemption amounts. • NC does not conform to federal itemized deductions. • NC allows cost of capital asset purchases to be deducted over a five-year period in place of federal law that allows the cost to be deducted in one year. • NC eliminated tax credits that were based on federal tax credits. This section would decouple from two of the tax changes included in TCJA: • The deferral of gain and the exclusion of gain for assets invested in an Opportunity Fund.	

[1] The provisions are effective when they become law except as otherwise noted in this column.

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	• The inclusion, and deduction, associated with foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). The Bipartisan Budget Act of 2018 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. The Act also extends three provisions from which NC has historically decoupled. This section decouples 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.	
1.2	Makes the adjustments necessary to State net income to decouple from the recently enacted FDII, GILTI, and Opportunity Zone provisions.	Applies to taxable years beginning on and after January 1, 2018.
1.3	Makes the adjustments necessary to North Carolina taxable income to decouple from the recently extended provisions in the Bipartisan Budget Act of 2018 noted in Section 1.1 of this summary and from the Opportunity Zone provisions.	Applies to taxable years beginning on and after January 1, 2018.
1.4	Removes unnecessary language in the definition of "wages".	Applies to taxable years beginning on and after January 1, 2018.
1.5	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.[2]	Applies to taxable years beginning on and after January 1, 2018.
1.6	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 NC standard deduction, taxpayers with income less than the federal standard deduction amount but more than the NC standard deduction amount would not be required to file an NC tax	Applies to taxable years beginning on and after January 1, 2018.

[2] Section 13305 of P.L. 115-97.

	return although NC income tax may be due. This change corrects this problem.	
PART II. BUSINESS TAX CHANGES		
2.1	Amends the definition of a "corporation" for purposes of the application of the franchise tax to include partnerships that elect to be taxed as a corporation. Under current law, the definition includes limited liability companies that elect to be taxed as corporations but not partnerships. This change would equalize the treatment among all business entities that either are corporations or choose to be taxed as one. Moreover, the change makes franchise tax treatment consistent with the income tax treatment.	1/1/18, and applies to calculation of franchise tax reported on the 2017 and later returns.
2.2	Does two things as it relates to the determination of net worth for franchise tax purposes: • Eliminates unnecessary vague language to make clear that if a corporation does not maintain its books in accordance with generally accepted accounting principles, then its net worth is computed in accordance with the method it uses for federal tax purposes. • Prevents a double deduction of treasury stock that is already captured in the current franchise tax calculation.	1/1/18, and applies to calculation of franchise tax reported on the 2017 and later returns.
2.3	Provides guidance to the Department with respect to the term "income-producing activity" for apportionment purposes.	
2.4	Repeals references in the corporate addback statute to credits or deductions that have expired.[3]	
2.5	Clarifies when a taxpayer must notify the Secretary as the result of either a federal correction or a voluntarily filed amended return that affects the amount of State tax payable. Similar changes are being made to both statutes that address federal corrections, the one for corporate taxpayers (G.S. 105-130.20) and the one for individual income taxpayers (G.S. 105-159). Under current law, if a taxpayer's State tax payable is affected by a federal determination, the taxpayer must file an amended return with the Secretary within 6 months of being notified, regardless of whether the amount owed is increased or decreased. Moreover, current law does not specify what constitutes "a final determination by the federal government." This section incorporates a cross-reference to a new definition of "federal determination," which means a change or correction of federal tax due arising from an audit of the Commissioner of Internal Revenue. It also provides that if a taxpayer voluntarily files an amended federal return, the taxpayer must file an amended State return if it results in an increase in State tax payable. An amended State return is optional if the adjustment results in less tax owed.	

[3] G.S. 105-130.47 is the film credit that expired January 1, 2015. G.S. 105-129.16H is the credit for donating funds to a nonprofit or unit of State or local government to enable the acquisition of renewable energy property, which expired January 1, 2017. Section 199 of the Code is the domestic production activities deduction that was repealed in the TCJA.

2.6	Clarifies that non-North Carolina captive insurance companies, which are those licensed and taxed in another state, are not subject to the tax on captive insurance companies, the corporate income tax, the franchise tax, or the gross premiums tax. No state taxes a foreign captive insurance company despite the fact that the insured risk may be located in the state.	
2.7	Re-enacts a provision that was inadvertently not roll-called during the 2017 Session. Section 4 of S.L. 2017-151 added massage and bodywork therapists to the list of professionals that are required to pay the annual $50 State privilege license tax. However, the bill was not roll-called at the time of enactment as required by the NC Constitution.	Applies to taxable years beginning on and after July 1, 2018.
PART III. PERSONAL TAX CHANGES		
3.1	Provides more specificity with regard to the expiration of the Historic Rehabilitation Tax Credits. This clarification will provide the Department with certainty as to when the tax credit can be removed from tax return forms.	
3.2	Clarifies a taxpayer's filing requirements as the result of a federal determination or when a taxpayer voluntarily files an amended federal return. These changes mirror those made in Section 2.5 of the bill.	
3.3	Deletes a reference to an expired credit that is not permitted to be claimed by an estate or trust. G.S. 105-153.10 is the child credit that is repealed for tax years beginning on or after January 1, 2018.	
3.4	Incorporates the changes made to G.S. 105-159 with regard to its application to estates and trusts (See Section 2.5 of this summary).	
3.5	Incorporates the changes made to G.S. 105-159 with regard to changes to the amount of withholding tax an employer is required to pay under the Code. (See Section 2.5 of this summary).	
3.6	Restores the "out of business" provision, which directs employers as to when they must file the withholding reconciliation informational return if the employer terminates its business during the calendar year. In 2015, the General Assembly changed the due date for filing the NC-3 Form from "the same date the employer's federal information return of federal income taxes withheld from wages is due under the Code" to "January 31." Under the Code, an employer that goes out of business is required to file the federal reconciliation report with the IRS within 30 days from the last day the taxpayer has payroll. An unintended consequence of changing the due date without reference to the Code was the loss of this 30-day provision. This change restores that requirement for NC tax purposes.	
3.7	Provides an exception to the general statute of limitations for assessments proposed from adjustments voluntarily filed with the IRS that affect State tax payable.	

3.8	Clarifies the meaning of the term "federal determination" to be a change or correction of the amount of federal tax due arising from an audit by the Commissioner of Internal Revenue. The current law refers to a "final determination by the federal government," but it is unclear as to what stage in the process this refers to.	
3.9	Requires franchisors to file informational returns electronically with the Secretary, similar to the informational returns currently required of occupational licensing boards, alcohol vendors, and payment settlement entities. The new report was requested from the Department's Examination Division to assist in the review of cash intensive businesses, specifically gross receipt audits.	
3.10	Repeals a provision that creates a double income tax benefit for funds in a Personal Education Savings Account (PESA). G.S. 105-153.5 allows a State tax deduction for amounts deposited into a PESA account during the taxable year; this deduction would remain in place. This section repeals a provision that excludes the same funds from taxable income.	For taxable years beginning on or after January 1, 2018.
PART IV. SALES AND USE TAX CHANGES		
4.1	Makes various stylistic and clarifying changes to sales tax definitions. The following changes are of note: • In subdivision (33c), language is being added regarding certain requirements for datacenters to address the fact that, often there are no jobs at the time of application for a written determination. • In subdivision (33*l*), the language that creates an exemption for security or other monitoring services from taxable RMI services is being moved to the exemption statute (See Section 4.8 of bill). • In subdivision (37), the addition of "without any deduction" language parallels the Streamlined Sales Tax Agreement definition. • In subdivision (45a), the reference date to the Streamlined Agreement is updated to the most recent iteration. • In subdivision (49), a reference in the definition of "use" is being deleted because it is no longer applicable on or after January 1, 2017, as a result of the change to the definition of "storage" for sales and purchases.	
4.2	Merges the imposition of sales and use tax of repair, maintenance, and installation services with the taxation of the items themselves. This change alleviates the necessity of determining whether the imposition is on the sale of the item plus installation or on the RMI service. The taxation of the installation is the same, regardless of how it is classified; and this change removes any distinction that may exist.	
4.3	Does two things in the sourcing statute:	

	• Clarifies that the sourcing principles are generally for the benefit of the seller and that they do not alter the imposition of the use tax against a purchaser. • Provides guidance regarding the sourcing of computer software renewal. Currently, the statute is silent on this issue and the new language is per the Streamlined Agreement.	
4.4	Clarifies that certain activities are exempt from the sales and use tax on admission charges. The Department receives a number of inquiries regarding whether certain charges are subject to or exempt from the tax on admissions charges. Much of the administration of the tax hinges on the definition of "admission charges" which states, in part, "gross receipts derived for the right to attend an entertainment activity." The exemption for these activities is consistent with current practice, but by listing them explicitly in the statute, it will provide clearer guidance to taxpayers.	
4.5	Moves service contract exemptions from the service contract statute to the sales tax exemption statute. It is not a substantive change. (See Section 4.6 of the bill).	
4.6	Corrects a cross-reference.	
4.7	Provides a mechanism for a retailer who pays sales and use tax on property or services and subsequently resells the property or service at retail to recover the sales tax originally paid to a seller. The retailer would recover the sales tax originally paid by reducing taxable receipts by the taxable amount of the purchase price of the property or services resold for the period in which the retail sales occurs. The records of the retailer must clearly reflect and support the adjustment to taxable receipts for the period in which the adjustment is made. The General Assembly provided a temporary means for a retailer to recover sales and use tax originally paid on an item subsequently resold at retail last session in section 2.8 of S.L. 2017-204, and directed the Revenue Laws Study Committee to study the feasibility of providing a permanent means.	
4.8	Makes various technical and clarifying changes to the sales and use tax exemption statute. • Last year, the General Assembly repealed the 1%/$80 privilege tax on mill machinery and substituted a sales tax exemption. The intent was to keep the interpretation and application of Article 5F the same, but to eliminate the tax on those items. Under the prior law, G.S. 105-187.51 specified that the term "accessories" did not include electricity. This caveat was inadvertently dropped when the language was moved into the sales tax exemption statute. This corrects the omission. • Subdivision (13) clarifies the taxation of over-the-counter drugs. In 2003, NC changed its taxation of drugs to use the defined terms	

	under the Streamlined Sales and Use Tax Agreement. Since that time, drugs required by federal law to be dispensed only on prescription and over-the-counter drugs sold on prescription have been exempt from sales tax and the Department's Directives have provided guidance that adheres to the statutory exemptions. However, several questions continue to arise in this area and the intent of the amendment to this subdivision is to clarify the statutory language and adhere to the historical application. The amendment makes it clear that pet food is subject to tax, even if the manufacturer of that food requires that the food be sold on prescription; the exemption only applies to drugs required by *federal law* to be dispensed only on prescription. The amendment also makes it clear that over-the-counter drugs used to treat a patient in a medical facility are subject to tax; the exemption only applies to over-the-counter drugs *sold* on prescription. • Subdivision (15) provides guidance with respect to "worthless accounts" by reference to "bad debts" under the Code. • Restates the current exemptions from the tax on RMI services and service contracts for security monitoring and providing a certified operator for a wastewater system, which are being relocated from a different statute. This language does not create a substantive change. • Subdivision (70) is not a substantive change but merely corresponds with and cross-references the statute that sets out how to administer the tax on accommodations. That statute currently provides exemptions for private residences rented for fewer than 15 days a year, an accommodation provided for 90 or more days, and accommodations provided by a school, camp, or similar entity where a fee is charged for enrollment.	
4.9	Provides that remedies, vaccines, medications, litter materials, feeds, rodenticides, insecticides, and other substances may be exempt from sales and use tax if purchased for use on animals and plants held or produced for commercial purposes by a qualifying farmer. Prior to the tax law change made in 2014, these substances were exempt from tax if purchased for use on animals or plants held or produced for commercial purposes. Effective July 1, 2014, these substances *had to be purchased by a qualifying farmer* to meet the exemption requirements. Under the change made by this section, the exemption applies regardless of who purchases the substances so long as the substances are used to provide a service to a person who holds a qualifying farmer exemption certificate or a conditional farmer exemption certificate.	Retroactive to July 1, 2014
4.10	Adds the term "taxable" to the statute authorizing a sales tax refund on certain purchases by an interstate carrier. By adding this term, it will identify that motor vehicle service contracts are exempt from sales and use taxes and will eliminate the requirement to include purchases of various items that are exempt from sales and use tax.	

	Since the refund is calculated using a ratio reflecting in-State mileage which is then multiplied by the purchase price of the items purchased, the refund is amount is more accurately reflective of the formula if only taxable items are included within the total purchase price of items.	
4.11	Makes a technical change to accurately correspond with defined term.	
4.12	Eliminates a provision limiting the Secretary to extend the time for filing a sales tax return to no more than 30 days after the regular due date of the return. This change came about as the result of needing to extend the time beyond the 30-day period for taxpayers who were affected by Hurricane Matthew. With the change, sales tax extensions would be governed by G.S. 105-263 without the 30-day limitation. Under that statute, an extension of time for filing a return other than a franchise tax return or an income tax return extends the time for paying the tax due and the time when the penalty attaches for failure to pay the tax. However, interest accrues on the tax due from the original due date of the return.	
4.13	Makes two changes in the direct pay permit statute: • Clarifies that a direct pay permit is not applicable to any of the items that are subject to the combined general rate of tax, with the exception of telecommunication service as allowed under G.S. 105-164.27A(b). • Clarifies that items withdrawn from inventory and sent to another state are subject to tax in NC because the first "use" occurs in this State. This change is consistent with removal of the exceptions from the definition of "storage," effective January 1, 2017.	
4.14	Adds facilitators to the statute that authorizes the Secretary to estimate tax due and assess entities with sales tax remittance obligations when those entities fail to file a return or file a false or fraudulent return. They are being added because facilitators have sales tax remittance obligations under the sales tax statutes along with retailers and wholesale merchants.	
4.15	Corrects a date in the statute that provides a grace period for retailers with regard to sales tax obligations on mixed contracts. Since the definition of a "mixed contract" is not effective until January 1, 2017, the date needs to be moved out to January 1, 2018.	
4.16	Corrects a cross-reference due to the repeal of a subsection.	
PART V. EXCISE TAX CHANGES		
5.1	Modifies definition of a "vapor product" for purposes of the tobacco products tax to reflect that, as of rules finalized in August of 2016, the U.S. Food and Drug Administration (FDA) now regulates all tobacco products, including e-cigarettes and nicotine in e-liquids under the terms of the Tobacco Control Act.	
5.2	Replaces the phrase "wholesaler or retailer registered through the Secretary" with the term "purchaser" to make the statutory language internally	

	consistent as the term "purchaser" is used to reference the nonresident vendor throughout the remainder of the statute.	
5.3	Removes language indicating that a retail dealer may make tobacco products at their place of business. In practice, only licensed wholesale dealers should be making or manufacturing any tobacco product.	
5.4	Requires the listed ABC permit holders to register with the Department and to notify the Department when a permittee discontinues their business. Certain ABC permit holders must pay excise taxes. Most of these permittees hold commercial ABC permits, which remain valid indefinitely. Because these permittees do not have to renew their permits annually, they do not fall under the procedure to confirm State tax compliance, which only applies to newly issued permits and annual permit renewals. This new statute would provide the Department with a mechanism for requiring this type of permittee to comply with tax obligations.	Effective October 1, 2018.
5.5	Removes language indicating that a bond for nonresident vendors may be made "by a pledge of obligations of the federal government, the State, or a political subdivision of the State." This same language was removed from a different section of the statute in S.L. 2014-3. In practice, only surety bonds or irrevocable letters of credit are accepted to satisfy the bonding requirement.	
5.6	Adds a tobacco product licensee's address to the list of information permitted to be disclosed by the Department. Under current law, the Department is authorized to provide public access to a list of the names and account numbers of tobacco products licensees. Because tobacco product licensees are required to obtain a license for "each place of business," then without also disclosing the physical address of each license, the user of the public access list cannot discern if the particular location is, in fact, licensed.	
5.7	Modifies the language directing the manner in which the Department obtains data for the Consumer Price Index (CPI) in order to calculate the motor fuel tax rate. The current tax rate calculation language[4] specifies that the data needed to calculate the CPI portion of the tax rate must be obtained through "the detailed report released in the October prior to the applicable calendar year by the Bureau of Labor Statistics…." As of June 2017, the Bureau of Labor Statistics stopped publication of the detailed report, and instead, releases the same information via publicly accessible databases available on the Bureau's website. By allowing for the use of "data determined by the Secretary to be equivalent," the Division will continue using the same data that was intended by the original enactment, but this will clarify that since the "detailed reports" are no longer available, the Bureau of Labor Statistics are an equivalent source.	

[4] Enacted in S.L. 2015-2.

5.8	Increases the motor fuel tax rate for those gas stations deemed to be a special class under S.L. 2016-23 each year in accordance with the rate increase in South Carolina. Section 2.(b) of S.L. 2016-23 designated a class of gas stations (currently limited to one) that were recognized as being in North Carolina as a result of the boundary recertification as a special class of property authorized to charge a motor fuel tax rate of 16 cents per gallon, which was the rate charged by South Carolina at the time of enactment. The session law also directed the Revenue Laws Study Committee to monitor the rate of the gas tax charged by South Carolina and authorized the Committee to recommend an increase to the motor fuel tax rate charged by these establishments up to the amount charged in South Carolina, should the rate in South Carolina change. In 2017, the South Carolina Legislature passed House Bill 3516, which permanently increased the motor fuel tax rate by 2 cents per gallon each year for the next 6 years, totaling 12 cents over that time, beginning July 1, 2017.	
PART VI. OTHER TAX CHANGES		
6.1	Clarifies that the imposition of a revenue suspension, which is an act done by the Secretary of State at the direction of DOR, does not mean that the suspended corporation or LLC ceases to be liable following the suspension for accrued, current, or subsequent State taxes; rather the tax liability remains unaffected by the suspension.	
6.2	Clarifies the expiration date of a provision that allows the Secretary to compromise the liability of a retailer who is assessed for failure to properly collect sales tax on admission charges, service contracts, prepaid meal plans, or aviation gasoline and jet fuel. The language is being adjusted to mirror the language in G.S. 105-237.1(a)(7) because the intent was for the provision to be tied to a certain reporting period and not for the expiration to be tied to when assessments are issued.	
6.3	Adds references to recently created property tax exemptions to the list of those for which a property owner must file a single application. Generally speaking, a property owner seeking a property tax exemption must file an annual application. There are some exceptions, under which either no application is required or only a one-time application is required. This section adds the following exemptions to the single application requirement; these exemptions were established in recent years but corresponding changes were not made to the application statute: • Real property occupied by charter schools • Energy mineral interest in property for which a permit has not been issued under G.S. 113-395. • Real and personal property located on lands held in trust by the United State for the Eastern Band of Cherokee Indians, regardless of ownership.	

	• A mobile classroom or modular unit that is occupied by a school and used exclusively for educational purposes.	
6.4	Corrects a cross-reference.	
6.5	Requires that lunch and dinner meals, served at the option of guests staying at a bed and breakfast home or inn, be charged separately on the guest's bill and, therefore, are not included in the room rate. This change corrects a provision enacted last year to more accurately reflect the General Assembly's intent.	Effective July 1, 2018.
6.6	Waives an antiquated restriction regarding sales and use tax revenue distributed to a municipality for water and sewer capital outlay purposes. G.S. 105-487(b) required a municipality to use a percentage of the sales and use tax revenue distributed to it under Article 40 of Chapter 105 of the General Statutes, First One-Half Cent (½¢) Local Government Sales and Use Tax, only for water and sewage capital outlay purposes. This restriction was time-limited. Prior to the sunset of the restriction, a municipality could petition the Local Government Commission to waive part or all of the restriction if the municipality demonstrated that its water and sewer needs could be met without the use of the restricted sales tax revenue. A similar restriction existed under Article 42, Second One-Half Cent (½¢) Local Government Sales and Use Tax. The restrictions on this use expired more than 20 years ago. The General Assembly repealed the obsolete restrictions in S.L. 1998-98: G.S. 105-487(b) and G.S. 105-504. Some municipalities have monies in their enterprise funds received from sales and use tax distributions prior to the expiration of the restrictions. Those funds must be expended as provided in the statute that existed at the time of the distributions, unless the municipality petitions the Local Government Commission to waive the restriction and the petition is approved. Under 20-NCAC 03.0112, the Local Government Commission charges a fee of $625 for services rendered to obtain this approval. There are some municipalities who do not own or operate a water or sewer system. In at least once instance, the amount of revenue subject to the restriction is less than one thousand five hundred dollars ($1,500). This section would allow a municipality that does not own or operate a water or sewer system to expend those funds for any public purpose without the necessity of petitioning the Local Government Commission for approval.	
PART VII. EFFECTIVE DATE		
7.1	Except as otherwise provided, this act is effective when it becomes law.	