

# NORTH CAROLINA GENERAL ASSEMBLY



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## REVENUE LAWS STUDY COMMITTEE

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### REPORT TO THE 2018 SESSION of the 2017 GENERAL ASSEMBLY OF NORTH CAROLINA

MAY 9, 2018

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## TABLE OF CONTENTS

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|   |    |
|---|----|
| LETTER OF TRANSMITTAL .....                         | 5  |
| COMMITTEE PROCEEDINGS .....                         | 7  |
| APPENDICES  |    |
| <u>APPENDIX A</u>                                   |    |
| MEMBERSHIP OF THE REVENUE LAWS STUDY COMMITTEE..... | 12 |
| <u>APPENDIX B</u>                                   |    |
| COMMITTEE CHARGE/STATUTORY AUTHORITY .....          | 13 |
| <u>APPENDIX C</u>                                   |    |
| LEGISLATIVE PROPOSAL .....                          | 16 |
| <u>APPENDIX D</u>                                   |    |
| MEETING AGENDAS .....                               | 17 |

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# TRANSMITTAL LETTER

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May 15, 2018

[\[Back to Top\]](#)

TO THE MEMBERS OF THE 2018 REGULAR SESSION  
OF THE 2017 GENERAL ASSEMBLY

The REVENUE LAWS STUDY COMMITTEE, respectfully submits the following report to the 2018 Regular Session of the 2017 General Assembly.

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Sen. Tommy Tucker (Co-Chair)

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Rep. William Brawley (Co-Chair),

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Rep. Jason Saine (Co-Chair)

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# COMMITTEE PROCEEDINGS

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[\[Back to Top\]](#)

Article 12L of Chapter 120 of the General Statutes establishes the Revenue Laws Study Committee, which serves as a permanent legislative commission to review issues relating to taxation and finance. The Revenue Laws Study Committee originated as a subcommittee of the Legislative Research Commission in 1977. In 1997, the General Assembly made it a permanent statutory legislative commission. The Committee consists of 20 members, 10 appointed by the President Pro Tempore of the Senate and 10 appointed by the Speaker of the House of Representatives. This biennium the Committee membership also included six advisory members. The Co-Chairs for 2017-2018 are Senator Tommy Tucker and Representatives Bill Brawley and Jason Saine. The membership of the Committee is included in Appendix A.

In its study of the revenue laws, G.S. 120-70.106 gives the Committee a very broad scope, stating that the Committee "may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable." A copy of Article 12L of Chapter 120 of the General Statutes is included in Appendix B. The Revenue Laws Study Committee met 2 times after the 2017 Regular Session. The following is a brief summary of the Committee's proceedings. Detailed minutes and information from each Committee meeting are available in the Legislative Library and may also be accessed online at the Committee's website: [Revenue Laws Meeting Materials](#).

## **2017 Tax Changes**

The Revenue Laws Committee heard a presentation covering the tax changes made during the 2017 Session of the North Carolina General Assembly: [Revenue Laws 2017 Tax Changes](#). In S.L. 2017-57, the General Assembly continued its policy of rate reduction for personal and business taxes. For tax years beginning on or after January 1, 2019, the personal income tax rate will be reduced to 5.25% and the corporate income tax rate will be reduced to 2.5%. The standard deduction for individual taxpayers will be increased for taxable years beginning on or after January 1, 2019. Another change with regard to personal income taxes is the conversion of the child tax credit to a child tax deduction, which became effective for tax years beginning on or after January 1, 2018. In addition to income tax rate reductions, this legislation reduced the franchise tax for S-corporations by imposing a flat \$200 tax on the first one million dollars of net worth, and \$1.50 per \$1,000 of net worth above one million dollars. This change is effective for taxable years beginning on or after January 1, 2019, and applicable to the calculation of franchise tax reporting on the 2018 and later corporate income tax returns. Lastly, this legislation repealed Article 5F, related to the 1%/\$80 tax on mill machinery and certain other equipment, and exempted the items previously taxable under this Article from sales tax. This tax change becomes effective July 1, 2018.

The General Assembly clarified the sales and use tax applicable to repair, maintenance and installation (RMI) services. S.L. 2017-204 more clearly defined RMI services to include the installation of an item to replace a similar existing item and the replacement of more than one of a like-kind item. It amended the definition of a capital improvement to remove the requirement that an addition or alteration to real property must vest in the owner of the property for the transaction to be considered a capital improvement for sales tax purposes. This change means that lessees will be treated similarly to owners when undertaking capital improvement projects of leased real property. The legislation also increased the percentage for all transactions in a mixed transaction contract to be taxable as a capital improvement from 10% to 25%.

The Department of Revenue has issued several notices, publications, and directives to assist taxpayers in determining whether a transaction is taxable as RMI services or a capital improvement. On April 18, 2018, the Department updated its information to incorporate the changes made in 2017. [DOR Chart of Taxable RMI services](#). The chart is not meant to provide specific tax advice to taxpayers, but can be used as a general guide as to whether a transaction could be considered a RMI service or a capital improvement. To further assist taxpayers as they become educated about the expanded sales and use tax base, the General Assembly enacted the Sales Tax Base Expansion Protection Act. Under that Act, the Department cannot assess tax due for a filing period within the defined grace period if one or more of the conditions of the Act are met. The Department has published information about this grace period on its website. [DOR Notice on Sales Tax Base Expansion Protection Act](#).

## **IRC Update**

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.<sup>1</sup> The General Assembly determines each year whether to update its reference to the Code.<sup>2</sup> Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made. Maintaining

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<sup>1</sup>North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

<sup>2</sup>The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."



conformity with federal tax law simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset.

Congress enacted two pieces of legislation since January 1, 2017, that impact the calculation of federal taxable income, and the calculation of State taxable income to the extent State law tracks federal law:

- The Federal Tax Cuts and Jobs Act (TCJA) made numerous changes to the calculation of federal taxable income. The impact of the federal changes under this Act on North Carolina are not as significant as they may be in other states due to the tax reform changes the General Assembly has enacted since 2011. [Federal Tax Reform's Impact on NC Tax Revenues](#).
- The Bipartisan Budget Act of 2018 contained many provisions that are expected to have minimal fiscal impact on State tax revenues, but may be important to individual taxpayers. Two of the more notable provisions are the changes to 529 college savings plans and the temporary reduction in the threshold for deductibility of medical expenses from 10% to 7% of income for the 2017 and 2018 taxable years. [Estimated Fiscal Impact of Conformity to Federal Tax Changes](#) and [Notable Provisions Applicable to NC Tax Calculation](#).

Part I of the Legislative Proposal would update 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 TCJA and the Bipartisan Budget Act of 2018 will apply to North Carolina. The legislative proposal would decouple from the following provisions:

- Income exclusion for forgiveness of debt on primary residence. The State has historically decoupled from this provision.
- Mortgage insurance deductible as mortgage interest. The State has historically decoupled from this provision.
- Deduction for tuition and expenses. The State has historically decoupled from this provision.
- The deferral of gain and the exclusion of gain for assets invested in an Opportunity Fund.
- The inclusion, and deduction, associated with foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI).

### **Report on Mandatory State Extension Form**

S.L. 2017-204, Section 1.14, directed the Department of Revenue to provide a report to the Revenue Laws Study Committee on the Department's findings regarding options to eliminate the Department's mandatory extension form currently needed to receive an extension of time to file franchise, corporate income, and individual income tax returns. [DOR Report on Mandatory State Extension Form](#). The Department presented its findings

to the Revenue Laws Study Committee. [DOR Presentation on Mandatory State Extension Form.](#)

Taxpayers must file a State extension form to receive a six-month extension of time to file a return. An extension of time to file the return does not extend the time to pay the amount of tax due. The NC Association of CPAs have advocated for a change in the State law that would allow an automatic six-month extension to all taxpayers who file and receive a federal extension, without the necessity of filing a separate State extension form. The Department contacted the following states that grant extensions to file state income tax returns based on approved federal extensions: South Carolina, Pennsylvania, Maine, and Rhode Island.

Based upon the Department's findings, the Department recommended that the State continue to require a separate State extension form be submitted for an extension to file a State tax return if tax is due. However, if no tax is due, and the taxpayer files a timely federal extension, the taxpayer would not be required to file a separate State extension form. The NC Association of CPAs spoke at the meeting and voiced concern about the practical viability of this option, since it is based upon "no tax due". The Committee chairs directed the staff to work with the Department and the NCACPAs to see if an agreement could be reached. No agreement was reached.

### **Report on Tax Compliance**

G.S. 105-256(a)(8) directs the Department of Revenue to submit a tax compliance report semiannually. [DOR Tax Compliance Report.](#)

### **Worker Classification Issues with Marketplace Providers**

Workers are generally classified as either employees or independent contractors depending on the level of control exercised by the business. Employees are entitled to benefits such as employer contribution to federal payroll taxes, unemployment insurance, workers' compensation, minimum wage and overtime pay, and employer responsibility for protection and conduct.

The Committee staff presented an overview of the issue, and Gina Fornario, Assistant General Counsel for Handy Technologies, Inc., presented a legislative proposal for the Revenue Laws Study Committee's consideration. The proposal recommended by Handy Technologies would classify workers for marketplace platforms as independent contractors. The Committee discussed the problem of worker misclassification where workers who are employees are denied benefits by classification as independent contractors. The Committee also questioned Ms. Fornario about how Handy Technologies, Inc. conducts business in the State.

### **Update on USSC Case: South Dakota v. Wayfair, Inc.**

## **Consensus Revenue Forecast Update**

### **Various Changes to the Revenue Laws**

The Revenue Laws Study Committee is charged with reviewing the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable. The Department of Revenue submitted a list of tax law changes for the Committee to consider. The Legislative Proposal consists of many of the recommendations submitted to the Committee by the Department. The Committee reviewed the proposal at its April meeting, and posted the proposal on its website. The Committee invited interested parties to review the bill draft and to contact the Committee's staff with any questions, concerns, or suggestions. The Committee staff worked with the Department and interested parties on the bill draft prior to the Committee's final meeting in May.

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## COMMITTEE MEMBERSHIP

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[\[Back to Top\]](#)

2017-2018

**President Pro Tempore of the Senate**  
**Appointments:**

Sen. Tommy Tucker (Co-Chair)

Sen. Jerry W. Tillman (Vice-Chair)

Sen. Tamara Barringer

Sen. Dan Bishop

Sen. Ben Clark

Sen. Chuck Edwards

Sen. Joel D. M. Ford

Sen. Brent Jackson

Sen. Floyd B. McKissick, Jr.

Sen. Bill Rabon

Sen. Ralph Hise (Advisory Member)

Sen. Paul Newton (Advisory Member)

Sen. Trudy Wade (Advisory Member)

**Speaker of the House of Representatives**  
**Appointments:**

Rep. William Brawley (Co-Chair),

Rep. Jason Saine (Co-Chair)

Rep. Stephen M. Ross (Vice-Chair)

Rep. Kelly M. Alexander, Jr.

Rep. Becky Carney

Rep. Julia C. Howard

Rep. Susan Martin

Rep. Robert T. Reives, II

Rep. Mitchell S. Setzer

Rep. John Szoka

Rep. Jon Hardister (Advisory Member)

Rep. Kelly E. Hastings (Advisory Member)

Rep. David R. Lewis (Advisory Member)

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## COMMITTEE CHARGE/STATUTORY AUTHORITY

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[\[Back to Top\]](#)

Article 12L.

Revenue Laws Study Committee.

**§ 120-70.105. Creation and membership of the Revenue Laws Study Committee.**

(a) Membership. – The Revenue Laws Study Committee is established. The Committee consists of 20 members as follows:

- (1) Ten members appointed by the President Pro Tempore of the Senate; the persons appointed may be members of the Senate or public members.
- (2) Ten members appointed by the Speaker of the House of Representatives; the persons appointed may be members of the House of Representatives or public members.

(b) Terms. – Terms on the Committee are for two years and begin on January 15 of each odd-numbered year, except the terms of the initial members, which begin on appointment. Legislative members may complete a term of service on the Committee even if they do not seek reelection or are not reelected to the General Assembly, but resignation or removal from service in the General Assembly constitutes resignation or removal from service on the Committee.

A member continues to serve until a successor is appointed. A vacancy shall be filled within 30 days by the officer who made the original appointment. (1997-483, s. 14.1; 1998-98, s. 39; 2009-574, s. 51.1.)

**§ 120-70.106. Purpose and powers of Committee.**

(a) The Revenue Laws Study Committee may:

- (1) Study the revenue laws of North Carolina and the administration of those laws.
- (2) Review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable.
- (3) Call upon the Department of Revenue to cooperate with it in the study of the revenue laws.
- (4) Report to the General Assembly at the beginning of each regular session concerning its determinations of needed changes in the State's revenue laws.

These powers, which are enumerated by way of illustration, shall be liberally construed to provide for the maximum review by the Committee of all revenue law matters in this State.

(b) The Committee may make interim reports to the General Assembly on matters for which it may report to a regular session of the General Assembly. A report to the

General Assembly may contain any legislation needed to implement a recommendation of the Committee. When a recommendation of the Committee, if enacted, would result in an increase or decrease in State revenues, the report of the Committee must include an estimate of the amount of the increase or decrease.

(c) The Revenue Laws Study Committee must review the effect Article 42 of Chapter 66 of the General Statutes, as enacted by S.L. 2006-151, has on the issues listed in this section to determine if any changes to the law are needed:

- (1) Competition in video programming services.
- (2) The number of cable service subscribers, the price of cable service by service tier, and the technology used to deliver the service.
- (3) The deployment of broadband in the State.

The Committee must review the impact of this Article on these issues every two years and report its findings to the North Carolina General Assembly. The Committee must make its first report to the 2008 Session of the North Carolina General Assembly.

(d) An establishment to which permits may be issued pursuant to G.S. 18B-1006(n1), as enacted by S.L. 2016-23, is designated a special class of property under Section 2(2) of Article V of the North Carolina Constitution, and the motor fuel sold by that establishment is taxable in accordance with this subsection. Notwithstanding G.S. 105-449.80, the motor fuel excise tax rate for an establishment to which permits may be issued pursuant to G.S. 18B-1006(n1), as enacted by S.L. 2016-23, is sixteen cents (16¢) per gallon. The Revenue Laws Study Committee shall annually compare the motor fuel excise tax rate imposed by this subsection with the rate levied by the State of South Carolina on motor fuels and may recommend a change in the rate imposed by this subsection to an amount no greater than the rate then in effect for the State of South Carolina. An establishment designated as a special class of property by this subsection may obtain monthly refunds on the difference between the motor fuel excise tax imposed under G.S. 105-449.80 and the motor fuel excise tax imposed by this subsection. The Department of Revenue shall calculate for each calendar year the difference between the motor fuel excise tax that would have been imposed under G.S. 105-449.80 on the motor fuel sold by an establishment classified by this subsection in the absence of this classification and the motor fuel excise tax that was imposed on the motor fuel sold by the establishment due to the classification. The difference in taxes, together with any interest, penalties, or costs that may accrue thereon, are a lien on the real property underlying the establishment as provided in G.S. 105-355(a). The difference in taxes shall be carried forward in the records of the Department as deferred taxes. The deferred taxes for the preceding three calendar years are due and payable on the day this subsection becomes ineffective due to the occurrence of a disqualifying event; provided, however, the amount collected for deferred taxes pursuant to this subsection does not exceed the tax value of the property. A disqualifying event occurs when the title to the real property underlying the establishment is transferred to a new owner. A lien for deferred taxes is extinguished when the amount required by this subsection is paid. (1997-483, s. 14.1; 2006-151, s. 21; 2016-23, s. 2(b); 2017-102, s. 19.1.)

#### **§ 120-70.107. Organization of Committee.**

(a) The President Pro Tempore of the Senate and the Speaker of the House of Representatives shall each designate a cochair of the Revenue Laws Study Committee. The Committee shall meet upon the joint call of the cochairs.

(b) A quorum of the Committee is nine members. No action may be taken except by a majority vote at a meeting at which a quorum is present. While in the discharge of its official duties, the Committee has the powers of a joint committee under G.S. 120-19 and G.S. 120-19.1 through G.S. 120-19.4.

(c) The Committee shall be funded by the Legislative Services Commission from appropriations made to the General Assembly for that purpose. Members of the Committee receive subsistence and travel expenses as provided in G.S. 120-3.1 and G.S. 138-5. The Committee may contract for consultants or hire employees in accordance with G.S. 120-32.02. Upon approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional staff to assist the Committee in its work. Upon the direction of the Legislative Services Commission, the Supervisors of Clerks of the Senate and of the House of Representatives shall assign clerical staff to the Committee. The expenses for clerical employees shall be borne by the Committee. (1997-483, s. 14.1.)

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## **LEGISLATIVE PROPOSAL**

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[\[Back to Top\]](#)



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## MEETING AGENDAS

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[\[Back to Top\]](#)

### REVENUE LAWS STUDY COMMITTEE AGENDA

*Representative Bill Brawley*

*Senator Tommy Tucker*

*Representative Jason Saine*

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**Wednesday, April 11, 2018**  
**Room 544, Legislative Office Building**  
**9:30 a.m.**

- I. **Welcome and Opening Comments**
- II. **Brief Overview of Tax Law Changes Enacted in the 2017 Session**  
*Nicholas Giddings, Legislative Analysis Division, NC General Assembly*
- III. **DOR Report on Tax Compliance Initiatives and Results: July 1, 2017 – December 31, 2017**  
Semi-annual report submitted pursuant to G.S. 105-256  
*Alan Woodard, Director, Examination Division, Department of Revenue*
- IV. **DOR Report on Mandatory State Extension Form**  
Submitted pursuant to S.L. 2017-204, Section 1.14  
*Donna Powell, Director, Personal Taxes, Department of Revenue*
- V. **IRC Update: Tax Cut and Jobs Act and the Federal Budget Act**  
*Jonathan Tart, Fiscal Research Division, NC General Assembly*
- VI. **Bill Draft: Various Revenue Law Changes**  
*Trina Griffin, Legislative Analysis Division, NC General Assembly*
- VII. **Worker Classification Issues with Independent Contractors**
  - **Introductory Overview**  
*Greg Roney, Legislative Analysis Division, NC General Assembly*
  - **Marketplace Contractor**  
*Gina Fornario, Assistant General Counsel, Handy Technologies, Inc.*
- VIII. **Adjournment**

**REVENUE LAWS STUDY COMMITTEE AGENDA**

*Representative Bill Brawley*

*Senator Tommy Tucker*

*Representative Jason Saine*

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*Wednesday, May 9, 2018  
Room 544, Legislative Office Building  
9:30 a.m.*

- I. **Adoption of the Minutes from the April 11, 2018, Meeting**
  
- II. **Revenue Update**  
*Barry Boardman, Chief Economist, Fiscal Research Division, NCGA*
  
- III. **Update on South Dakota v. Wayfair, Inc.**  
*Trina Griffin, Principal Legislative Analyst, Legislative Analysis Division, NCGA*
  
- IV. **Bill Draft: Various Revenue Laws Changes**  
*Finance Team, NCGA*  
***This agenda item consists of two parts: (i) modifications to the bill draft distributed at the meeting on April 11, 2018, based upon comments and suggestions received by interested parties, the Department of Revenue, and Committee staff; and (ii) amendments incorporating changes that were not included in the bill draft distributed at the meeting on April 11, 2018.***
  
- V. **Adoption of Final Report**
  
- VI. **Adjournment**