



This Bill Analysis reflects the contents of the bill as it was presented in committee.

SENATE BILL 605: Various Changes to the Revenue Laws

2015-2016 General Assembly

Committee: Senate Finance	Date: July 22, 2015
Introduced by: Sens. Rucho, Rabon, Tillman	Prepared by: Cindy Avrette
Analysis of: Second Edition	Committee Counsel

SUMMARY: Senate Bill 605 makes various changes to the revenue laws.

BILL ANALYSIS: Except as otherwise provided, the sections in the bill would become effective when the act becomes law. Many of the changes in the bill are recommendations of the Department of Revenue.

Section	Bill Analysis
PART I: BUSINESS TAX CHANGES	
1.1	Repeals the annual franchise or privilege tax on mutual burial associations, effective for taxes payable on or after April 1, 2016. The Department of Revenue collected \$750 in franchise tax on mutual burial associations in 2014. The General Assembly repealed most of the State privilege license taxes in the mid-1990s as an archaic form of taxation. The tax rate varies from \$15 to \$50, depending upon the membership of the association. There are currently 60 to 65 mutual burial associations, and all but three have a tax liability of \$15.
1.2	Corrects a statutory cross-reference.
1.3	Defines a "qualified air freight forwarder" as a company that is an affiliate of an airline and whose air freight forwarding business is primarily carried on with that affiliated airline. The provision allows a qualified air freight forwarder to utilize its affiliated airline's revenue ton miles factor for purposes of apportioning its income to North Carolina. Without this change, an air freight forwarder that owns no planes would be considered a service company and would be subject to the three-factor apportionment formula.
1.4	Eliminate various deductions from the corporate and franchise tax laws that appear antiquated or obsolete. The deductions allowed in excess of the federal amounts, that would be eliminated by this Part, include the following: <ul style="list-style-type: none"> • Amortization of air cleaning devices • Emergency facilities acquired prior to January 1, 1955 • Reforestation and cultivation of commercially grown trees • Eligible income of an international banking facility Deductions that appear obsolete include the following: <ul style="list-style-type: none"> • Deductions for amounts paid as a marketing assessment on tobacco grown in NC • Interest, earnings, and gains of a trust re: tobacco settlement • Amounts paid from the Hurricane Floyd Reserve Fund • Amounts paid from the Disaster Relief Reserve Fund for hurricane relief The corporate income tax changes would become effective for taxable years beginning on or

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Senate Bill 605

Page 2

Section	Bill Analysis
	after January 1, 2016. The franchise tax changes would become effective for taxable years beginning on or after January 1, 2017. The franchise tax for taxable year 2017 is due and payable with the corporate income tax return for taxable year 2016. These changes are also in the Senate budget, H97, 7th edition.
PART II: PERSONAL TAX CHANGES	
2.1(a)	Restores a miscellaneous itemized deduction applicable when a taxpayer restores a substantial amount held under claim of right that the taxpayer included in gross income for a prior taxable year because it appeared that taxpayer had an unrestricted right to that item. This provision prevents a person from paying income tax on amounts the person did not receive. An example of this type of situation is a taxpayer who works on commission. The Department of Revenue recommended this change. This subsection becomes effective for taxable years beginning on or after January 1, 2014.
2.1(b)	Adds a deduction for the purpose of preventing double taxation of income. This section becomes effective for taxable years beginning on or after January 1, 2014. The American Recovery & Reinvestment Act of 2009 permitted an individual or a corporate taxpayer with income from business indebtedness discharged by the reacquisition of a debt instrument occurring in 2009 or 2010 to defer that income until 2014. Beginning in 2014, the taxpayer is required to recognize the income ratably over a 5-year period for federal income tax purposes. NC decoupled from this federal law change in S.L. 2009-451. Therefore, the taxpayer has already recognized the income for State tax purposes. In 2009, G.S. 105-134.6 was amended to provide a deduction from federal taxable income for this income. The deduction was inadvertently omitted from the list of deductions when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5.
2.2	Provides that an individual taxpayer must adjust federal adjusted gross income to prevent a double benefit of the federal net operating loss (NOL) carryover. This provision becomes effective for taxable years beginning on or after January 1, 2015. North Carolina piggybacks the federal NOL law, which instructs taxpayers to deduct the entire amount of NOL being carried to that year. If all of the NOL is not used, the unused amount is carried forward to the succeeding year. If North Carolina has additions to federal taxable income, they would be offset by the unused NOL and the taxpayer would also benefit from the unused NOL in the succeeding year. To prevent the double benefit, this addition to federal adjusted gross income is needed. The adjustment was required under G.S. 105-134.6, but was inadvertently omitted when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5.
2.3	Corrects a statutory reference and removes obsolete language.
2.4	Repeals the income tax refund check-off for a charitable contribution to the North Carolina Education Endowment Fund. This section becomes effective for taxable years beginning on or after January 1, 2015. Through June 2015 of this year, \$56,388 had been transferred to the NC Education Endowment Fund. ¹
PART III: SALES TAX CHANGES	

¹ There is one other long-standing income tax refund check-off provision for the Wildlife Conservation Account. Through June 2015, \$119,165 had been transferred to that account through this provision.

Senate Bill 605

Page 3

Section	Bill Analysis
3.1	S.L. 2014-66 clarified the authority of the Department of Revenue to collect the 911 fee paid on prepaid wireless service. This section conforms the effective date of the collection authority to when the fee was initially imposed.
3.2(a)	This subsection does the following: <ul style="list-style-type: none"><li data-bbox="370 432 805 464">• Removes obsolete definitions.<li data-bbox="370 474 1482 653">• Clarifies the term "operator". Under the definition of "lease or rental of tangible personal property" the term does not include the lease or rental of tangible personal property provided with an operator whose presence, skill, knowledge, or expertise is necessary to bring about a desired or appropriate effect; and therefore the lease or rental of such property is not subject to sales tax.<li data-bbox="370 663 1349 695">• Updates the statutory reference to the Streamlined Sales Tax Agreement.
3.2(b)	This subsection does the following: <ul style="list-style-type: none"><li data-bbox="370 747 1482 852">• Simplifies the sales tax application for storage by removing exceptions that are problematic to administer because taxpayers often do not retain sufficient documentation to support the exceptions to the definition of "storage".<li data-bbox="370 863 1482 1409">• Changes the definition of "State agency" for purposes of the State government sales and use tax exemption and refund to specify that the term does not include occupational licensing boards or State governmental entities that are specifically designated to apply for a sales tax refund as opposed to receiving a sales tax exemption under G.S. 105-164.14 or listed under G.S. 105-251.2, as enacted by this act. An occupational licensing board is defined by G.S. 93B-1 to be "any board, committee, commission, or other agency in North Carolina which is established for the primary purpose of regulating the entry of persons into, and/or the conduct of persons within, a particular profession or occupation, and which is authorized to issue licenses; ... the term does not include State agencies, staffed by full-time State employees, which as a part of their regular functions may issue licenses." The NC Bar Association NC State Board of Certified Public Accountants are occupational licensing boards under that definition, and they are also listed under G.S. 105-251.2. As such, these entities would no longer be eligible for the State sales tax exemption. <p data-bbox="272 1419 935 1451">This subsection becomes effective January 1, 2016.</p>
3.3	Corrects a statutory cross-reference.
3.4	The tax treatment for receipts from a ticket reseller was changed in S.L. 2014-3. This section makes a conforming change by recognizing who is the retailer for purposes of that transaction.
3.5	Changes the term "affixed" to "applied" so the terminology is consistent with the terminology used in the definition and with the remainder of the statute.
3.6	Clarifies the reporting period a retailer who receives sales tax due from a facilitator must use.
3.7	Clarifies the law concerning motorsports and modifies sales tax preferences for motorsports. <ul style="list-style-type: none"><li data-bbox="370 1860 1482 1997">• Subsection (a) codifies the current administrative practice by exempting from sales and use tax a transmission, engine, or rear-end gears leased or rented by a professional motorsports racing team or a related member of a team for use in competition in a sanctioned race series. Under a final Revenue agency decision in

Senate Bill 605

Section	Bill Analysis
	<p>1997, an engine service program agreement was determined to not constitute the lease or purchase of tangible personal property and therefore not subject to sales and use tax. The General Assembly changed the definition of the term "lease or rental" in 2003 to conform to the definition of the term in the Streamlined Sales Tax Agreement. Since that time, the Ruling has conflicted with the plain meaning of the statute. This subsection codifies the current practice by exempting the transaction, but sunsets the exemption in four years. Under current law, if the underlying property subject to a service contract is exempt from sales tax, then the service contract on that item is exempt from sales tax. Therefore, this change in the law also means that a service contract on that item is exempt. When the exemption for the underlying property expires, so will the exemption for the service contract.</p> <ul style="list-style-type: none"> • Subsection (b) clarifies that the exemption from sales tax on a service contract for an item purchased by a professional motorsports racing team conforms to the corresponding sales tax refund provision for that item. This subsection applies to service contracts purchased on or after January 1, 2014; that is the date the sales tax on service contracts and the exemption for this item became effective. • Subsection (c) would extend the sales tax refund for sales tax paid by a professional motorsports racing team on tangible personal property that comprises part of a professional motorsports vehicle, other than tires or accessories until January 1, 2020; however, the amount of the refund will be phased down over that four-year period. Under current law, the refund is equal to 50% of the sales and use tax paid. The percentage of the refund will continue at 50% for items purchased in 2016; it will be 37.5% for items purchased in 2017; 25% for items purchased in 2018; and 12.5% for items purchased in 2019.
3.8	Replaces a term with the defined term.
3.9	<p>Changes the term "conditional service contract" to "conditional contract" so that the transactions in the statutory section will not be confused with a service contract. The transactions addressed in this section concern tangible personal property sold below cost if purchased with a contract. An example of this type of transaction is a mobile phone sold for a discounted price if purchased with a mobile phone plan. This section also clarifies what the presumed sales price of the item is when a portion of the conditional contract is taxable and a portion of it is not. The current law addresses the situation where the entire contract is taxable, or the entire contract is not taxable, but not the situation where it is partially taxable. This section provides that the presumed sales price of the item is equal to the percentage of the service in the contract that is not taxable. Lastly, it makes a conforming change to the local sales tax base to clarify that the local sales tax applies to the presumed sales price.</p>
3.10	<p>Subsection (a) repeals the sales tax exemption for items sold by a nonprofit organization when the receipts from the sale of the items will be directly or indirectly contributed to the State or school. An example of an entity that benefits from this exemption is a museum gift shop.</p> <p>Subsection (b) creates a new sales tax exemption for food, prepared food, soft drinks, and other items of tangible personal property sold not for profit for or at an event that is sponsored by an elementary or secondary school when the net proceeds will be given to the school. This section becomes effective January 1, 2016.</p>

Senate Bill 605

Page 5

<i>Section</i>	<i>Bill Analysis</i>
311	Provides that charges for installation, delivery, and interior design services must be separately stated and identified as such on the billing statement given to the purchaser to be exempt from sales tax. The Department requested this change.
3.12	Corrects a statutory reference and clarifies that fuel exempt from sales tax because it is sold to a manufacturer for use in connection with the operation of a manufacturing facility must be used in the manufacturing process. Fuel that is purchased by a manufacturer and not used in the manufacturing process is subject to sales and use tax at the general rate. This section becomes effective January 1, 2016.
3.13	Subsection (a) provides that the sales tax exemption for items purchased by a contractor apply to items purchased for the holder of a conditional farmer exemption certificate as well as the holder of a qualifying farmer exemption certificate. Subsection (b) corrects a statutory reference.
3.14	Makes an adjustment to the amount of sales tax paid on fuel by an interstate passenger air carrier to qualify for the refund so that the amount corresponds with the refund period. The amount of the tax that must be remitted before the refund provision applies is for a 12-month period. The refund provision expires January 1, 2016, thus creating a 6-month refund period.
3.15	Subsection (a) clarifies that the refund for indirect purchases made by a person on behalf of a nonprofit organization does not apply to purchases of prepared food and accommodation rentals. This clarification is consistent with how the State sales tax exemption and refund provisions are administered. Subsection (b) repeals a provision that allows a sales tax refund for sales tax liability incurred by a nonprofit entity through reimbursement to an authorized person of the entity for the purposes of the entity. This section becomes effective July 1, 2016. Under this change, only direct purchases by a nonprofit entity would be allowed for purposes of the sale tax refund.
3.16	Repeals an obsolete provision. The sales tax refund for businesses located in a low-tier area expired in 2014.
3.17	Removes the time period for which a person must maintain records. The three-year time period is misleading. Records should be retained for periods covered within a statute of limitations. The statute of limitations is generally three years. However, an ongoing audit may exceed a period of three years. And there is no statute of limitations for failure to file a return.
3.18	Adds "data" to the types of records the Secretary of Revenue may examine.
3.19	Makes changes necessitated by the Streamlined Sales and Use Tax Agreement. \The change will allow service providers adequate time to make changes to their systems. This section also allows the Department to makes adjustments as needed to the tax matrix used by certified service providers.
3.20	Provides that a certified service provider may file with either the Secretary or the Streamlined Sales Tax Governing Board a certificate of deposit, in addition to a bond or an irrevocable letter of credit.
3.21	Subsection (a) clarifies that a park model RV is a recreational vehicle and is subject to the highway use tax. Subsection (b) clarifies that a park model RV is a motor vehicle exempt from sales and use

Senate Bill 605

Page 6

Section	Bill Analysis
	tax.
3.22	Clarifies the application of the highway use tax on vehicles previously titled out-of-state. This provision is also in the Senate budget, H97, 7th Edition.
3.23	Clarifies that the white goods tax applies to any new white good purchased for storage, use, or consumption in this State.
3.24	Clarifies that the net proceeds of the One-Quarter Cent Local Option Sales Tax is allocated to the taxing county.
PART IV: EXCISE TAX CHANGES	
4.1	Conforms the bonding requirements entities that must pay excise tax for cigarettes, tobacco products, beer and wine. Provides that the entities must file a bond (or letter of credit) in an amount that is two times the monthly average liability of the taxpayer. The minimum amount of the bond is \$2,000, the maximum amount of the bond is \$2 million. The Secretary must periodically review the bonds, and adjust the amount based on changes in the taxpayer's liability.
4.2	Clarifies the applicability of the tax on other tobacco products to specify that the OTP rate does not apply to cigarettes that are taxed at 35¢ per pack, and does not apply to vapor products that are taxed at 5¢ per mL of consumable product.
4.3	Authorizes wine shippers to file excise tax returns on shipments once a year, rather than monthly.
4.4	Conforms the bonding requirements for the severance tax on energy minerals to the provisions for other excise taxes. Clarifies that the tax is imposed on the producer of the energy mineral. Repeals a provision that would have relieved the producer of paying the tax.
4.5	Makes three changes in regards to the disclosure of tax information: <ul style="list-style-type: none">• Clarifies when information regarding sales by a nonparticipating manufacturer may be disclosed for reports required by the MSA.• Authorizes the Department to provide a list of entities licensed under the tobacco products tax Article to aid in the administration of the tobacco products tax.• Authorizes the Department to disclose tax information regarding motor fuel tax compliance to other IFTA (International Fuel Tax Agreement) jurisdictions.
4.6	Conforms the statutes for temporary trip permits for motor carriers to the current Department practice.
4.7	Authorizes the Secretary to appoint a designee to enter into agreements regarding the administration of IFTA. The agreements entered into may not impact the amount of motor fuel taxes due.
4.8	Clarifies the interest rate applicable to IFTA taxpayers.
PART V: TAX COMPLIANCE AND TAX FRAUD PROVISION	
5.1(a)	Provides that the report an employer must file with the Department of Revenue re: to the amount of wages paid to an employee must be filed by January 31st and must be filed electronically. The Secretary could waive the electronic filing requirement for good cause.

Senate Bill 605

Page 7

<i>Section</i>	<i>Bill Analysis</i>
	The information must also be submitted to the IRS, but the time for submission dates would be different; under current law, the submission dates are the same. The Department has requested an earlier submission date to enable it to timelier match taxpayer information for the taxable year for which returns are being submitted.
5.1(b)	Makes the failure to file the informational return required by subsection (a) of this section subject to a \$50 penalty. This subsection becomes effective January 1, 2017, to enable the Department to educate employers on the State's earlier submission date before subjecting the employer to a penalty for failure to file the informational return by the due date.
5.1(c)	Requires a pension payer who withholds taxes to file an informational return with the Secretary on the amounts withheld.
5.1(d)	Requires the Lottery Commission to file an informational return with the Secretary on a person's winnings and the amounts withheld.
5.1(e)	Requires persons who must withhold income taxes from compensation paid to contractors to file an informational return with the Secretary.
5.2	Allows the Secretary to reduce or waive interest payments on past due taxes imposed during a period for which a taxpayer has declared bankruptcy.
5.3	Requires licensing boards to provide information to the Secretary re: licensees' names, addresses, taxpayer identification numbers, and license numbers. This section becomes effective July 1, 2016.
PART VI: OTHER TAX CHANGES	
6.1	Extends the time period for which the Department may transfer an assessment against a responsible person.
6.2	Repeals an obsolete statute. The State made its last transitional local government hold harmless payment for repealed reimbursements in 2013.
6.3	Repeals an antiquated statute in Chapter 131E, Public Hospitals and puts the provisions pertaining to the taxability of public hospitals in the tax statutes, Chapter 105. It refers to repealed taxes and contains a blanket statement that the authority is exempt from all taxes. In practice, the hospitals apply for a refund of sales and use tax paid, G.S. 105-164.14. The property tax statutes exempt real and personal property of a hospital authority created under G.S. 131E-17 from tax, G.S. 105-278.1. The bill adds two provisions to ensure that the tax treatment of interest income from bond obligations remains exempt from corporate and individual income tax, and that motor fuel purchased by a hospital authority created under G.S. 131E-17 remains exempt from excise tax.
6.4	Repeals a reference to a repealed statute. G.S. 153A-152 was repealed effective July 1, 2015.