



SENATE BILL 99: Appropriations Act of 2018, Sec. 38.5: Sales and Use Tax Changes

2017-2018 General Assembly

Committee:		Date:	July 11, 2018
Introduced by:		Prepared by:	Cindy Avrette Staff Attorney
Analysis of:	Sec. 38.5 of S.L. 2018-5		

OVERVIEW: *Sec. 38.5 of S.L. 2018-5 does the following:*

- *Provides an option for a retailer who pays sales and use tax on property or services, and subsequently resells them at retail, to recover the sales and use taxes the retailer originally paid.*
- *Extends the Sales Tax Base Expansion Protection Act for an additional year to better ensure retailers with sales tax obligations understand the applicable tax law changes.*
- *Clarifies the sales and use tax treatment of frequently questioned transactions.*
- *Streamlines, clarifies, and modernizes statutory language to comport with recent sales and use tax changes.*
- *Makes other miscellaneous and technical sales and use tax changes.*

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

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE: Sec. 38.5 of S.L. 2018-5 makes various changes to the sales and use tax laws. Unless noted otherwise, the changes became effective when they became law on June 12, 2018.

Subsection	Explanation	Effective Date
(a)	Clarifies that the term "mixed transaction contract" applies to real property transactions; it does not include a contract that consists of a capital improvement and repair, maintenance, and installation (RMI) services for tangible personal property.	Effective retroactively to January 1, 2017.
(b)	Makes various stylistic and clarifying changes to sales tax definitions. The following changes are of note: <ul style="list-style-type: none"> • 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 (33l), the language that creates an exemption for security or other monitoring services from taxable RMI services is being moved to the exemption statute {See subsection (j)}. The changes in this subdivision also separate services applicable to motor vehicles into one sub-subdivision. 	

Karen Cochrane-Brown
Director



Legislative Analysis
Division
919-733-2578

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	<ul style="list-style-type: none"> • In subdivision (37), the language clarifies that a credit allowed for a trade-in does not reduce the sales price of the item purchased. • 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. 	
(c)	Merges the imposition of sales and use tax of RMI 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.	
(d)	<p>Does two things in the sourcing statute:</p> <ul style="list-style-type: none"> • 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 consistent with the provisions of the Streamlined Sales and Use Tax Agreement. 	
(e)	<p>Clarifies that certain activities are exempt from the sales and use tax on admission charges.</p> <p>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.</p>	
(f)	Moves service contract exemptions from the service contract statute to the sales tax exemption statute. It is not a substantive change {See subsection (j)}.	
(g)	Corrects a statutory cross-reference.	Effective retroactively to January 1, 2017.
(h) and (i)	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.	

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	<p>The retailer could 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.¹ The records of the retailer must clearly reflect and support the adjustment to taxable receipts for the period in which the adjustment is made.</p> <p>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.</p>	
(j)	<p>Makes various technical and clarifying changes to the sales and use tax exemption statute. The notable changes are as follow:</p> <ul style="list-style-type: none">• 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. The change in subdivision (5e) 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 <i>federal law</i> 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 <i>sold</i> on prescription.	

¹ A retailer who purchases property or services for resell may purchase the items with a sales tax exemption certificate. If the items are subsequently used by the retailer, as opposed to resold, the retailer must remit use tax on the items purchased. The mechanism provided by this section give the retailer a different way to address this situation.

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	<ul style="list-style-type: none"> • Subdivision (15) provides guidance with respect to "worthless accounts" by reference to "bad debts" under the Code. A retailer may deduct worthless accounts from gross sales. • Relocates the current exemptions from the tax on RMI services and service contracts from the service contract statute. • 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. 	
(k)	<p>This subsection does two things:</p> <ul style="list-style-type: none"> • Clarifies that a qualifying farmer may be a person who boards horses. This clarification conforms to a similar change made to the present use value statutes last session. • 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 <i>had to be purchased by a qualifying farmer</i> 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. <p>Provides a person who paid sales and use tax for a return period ending prior to the date this subsection became law on an item exempt under this subsection may seek a refund directly from the Department of Revenue. The request must be made on or before October 1, 2018.</p>	Effective retroactively to July 1, 2014.
(l)	<p>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.</p>	

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	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 amount is more accurately reflective of the formula if only taxable items are included within the total purchase price of items.	
(m)	Makes a technical change to accurately correspond with defined term.	
(n)	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.	
(o)	Makes two changes in the direct pay permit statute: <ul style="list-style-type: none">• 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.	
(p)	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.	
(q)	Extends the Sales Tax Base Expansion Protection Act for an additional year to better ensure retailers with sales tax obligations understand the applicable tax law changes. Under the Act, impacted retailers are given a grace period under which the Department will not impose assessments if the retailer demonstrates a good faith effort to comply. It also adds transactions to the grace period that have been inadvertently omitted.	
(r)	Corrects a cross-reference due to the repeal of a subsection.	

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(s)	Makes a grammatical change.	
(t)	Provides that a consumer must keep records of items purchased inside the State, as well as outside the State. This change is needed to enable the Department to administer the new provision enacted by subsection (h) of this section that allows 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. It also highlights for the retailer the need to retain these records.	
(u)	Provides a sale tax exemption for that portion of the gross receipts derived from an admission charge that is described in section 170(l)(2) of the Code. Under the federal Tax Cuts and Jobs Act, a charitable deduction is no longer allowed for an amount paid to an educational institution of higher learning if the taxpayer receives, directly or indirectly, the right to purchase tickets for an athletic event. Under sales tax law, any amount deductible as a charitable contribution is exempt from sales tax. The amendment ensures that any change in the deductibility of a contribution for income tax purposes does not inadvertently broaden the sales tax base for admission charges.	
(v)	Modernizes the statute to recognize the expansion of the sales tax base to services.	
(w)	Modernizes the statute and makes changes consistent with provisions in Part VI of the act that provide a framework for the Department of Revenue to offer and prescribe the format for electronic filings.	
(x), (y), and (z)	<p>Defines a property management contract and provides that a property management contract is not subject to sales tax. The effective date is January 1, 2020. The service of providing property management is not currently subject to sales tax. However, RMI services that a property management company may perform in addition to its management services may be subject to sales tax.</p> <p>Directs the Revenue Laws Study Committee to review the amendments made by subsections (x) and (y), and to recommend any changes necessary to make the law concise, intelligible, easy to administer, and equitable.</p>	Effective January 1, 2020