

FALL 2021

NORTH CAROLINA STATE

AND LOCAL TAX UPDATE

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AN OVERVIEW OF TODAY'S DISCUSSION

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Collection

1 PART ONE

2 I. INDIVIDUAL INCOME TAX CHANGES

Page 5

- The 2017 and 2018 Legislative Sessions made several changes to the North Carolina individual income tax system. **Some of these changes went into effect in 2019.**

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And, Session Law 2019-237 (November 1, 2019) and Session Law 2019-246 (November 8, 2019) made additional changes.

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NCDOR Issues New Individual Income Tax Bulletins-January 2020

- Resident vs. Non-resident
- Taxation of Owners of Pass-Through Entities
- Employer Withholding

I. Reduced Flat Tax Rates.

Under Session Law 2017-57, the rate was lowered to 5.25% beginning in 2019.

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- However, beginning in 2019, the mandatory withholding rate on wages is 5.35%, even though the individual tax rate is only 5.25%.

New Increased Standard Deduction

Increased standard deduction beginning
in 2019 and 2020

<u>Filing Status</u>	2018 Standard <u>Deduction</u>	2019 Standard <u>Deduction</u>	2020 Standard <u>Deduction</u>
Single	8,750	10,000	10,750
Married/Separately	8,750	10,000	10,750
Head of Household	14,000	15,000	16,125
Married/Jointly	17,500	20,000	21,500

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PART TWO

NC “DECOUPLES” FROM 2020 LEGISLATION

PAGE 7

The U.S. Congress enacted two significant pieces of tax legislation in 2020.

First, the Taxpayer Certainty and Disaster Relief Act of 2019 (“TCDRA”) extended a number of federal tax provisions that were scheduled to expire at the end of 2019.

Then, the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”) was enacted to provide tax relief to taxpayers during the COVID-19 crisis.

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In the 2020 summer legislative session, Session Law 2020-58 (H.B. 1080), North Carolina adopted some of the changes enacted under TCDRA and the CARES Act.

For example, the TCDRA extended the 7.5% itemized medical expense deduction threshold for 2019 and 2020. Under new legislation, North Carolina will follow the more favorable 7.5% itemized medical expense deduction threshold. Session Law 2020-58 (H.B. 1080).

However, H.B. 1080 also contained a number of North Carolina tax provisions designed to “decouple” from TCDRA and the Federal CARES Act.

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On July 20, 2020, the NCDOR issued a very well written “Important Notice” describing various decoupling provisions in HB 1080 affecting individuals and corporations. Here is how North Carolina differs from the tax relief provisions under the TCDRA and the CARES Act.

A. No Deduction for Mortgage Insurance Premiums Deducted on the Federal Return. Under the federal TCDRA, mortgage insurance premiums continue to be treated as deductible mortgage interest. However, North Carolina continues to require an “add back” for mortgage insurance premiums deducted on the federal return.

B. Exclusion for Discharge of Qualified Principal Residence Indebtedness. Under the TCDRA, forgiven qualified principal residence indebtedness is excludable from gross income for federal tax purposes through the year 2020. However, North Carolina continues to require an addition to federal AGI for any cancelled debt that is excluded from federal taxable income.

C. Qualified Tuition and Related Educational Expense Deductions. Under the Federal TCDRA, in certain cases taxpayers may take a tax deduction for certain qualified tuition and related expenses. However, North Carolina requires an “add back” to federal AGI for any tuition deducted on the federal tax return.

D. Charitable Contribution Limitation. The CARES Act suspended the AGI percentage limitation (60%) on charitable contributions made in 2020. However, House Bill 1080 imposes the same AGI limitations on charitable deductions that existed before 2020 (60% of AGI). 105-153.5(a)(s)a.

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E. Changes to the Net Operating Loss Rules.

The 2017 Federal Tax Act legislation eliminated the ability to carry back NOLs.

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However, the CARES Act eliminated the prohibition on **NOL carrybacks** for certain NOLs arising in 2018, 2019 and 2020. In addition, the CARES Act now allows NOLs that were incurred in 2018, 2019 or 2020 to be carried back as far as 5 years.

The 2017 federal Tax Act also placed an 80% limitation on the amount of **taxable income that could be offset by an NOL**. However, the CARES Act eliminated the 80% limitation for NOLs **incurred in 2018, 2019 and 2020**.

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NC DECOUPLES

House Bill 1080 now requires that individual taxpayers “add back” the amount of any 2018, 2019 or 2020 NOL carried back into a prior year. NCGS 105-153.5(c2)(8). However, the amount of any North Carolina “add back” can be deducted over the next five (5) years starting in 2021. NCGS 105-153.5(c2)(14).

Likewise, North Carolina kept in place the 80% taxable income limitation on NOLs. So, any NOLs deducted for federal tax purposes in excess of the 80% limitation must be added back to the federal taxable income and then can be deducted in five (5) equal annual installments beginning in 2021. N.C.G.S. 105-153.5 (c2)(13) and (16).

F. Net Business Losses. Under the 2017 federal Tax Cuts and Job Act, there was a limit put in place on the amount of excess business losses that could be deducted by non corporate taxpayers. Under the CARES Act, this new limitation will be retroactively delayed until 2021.

House Bill 1080 now requires individual taxpayers “add back” any business losses deducted for federal tax purposes in 2018, 2019 and 2020 over and above the amount that would have been deductible prior to the enactment of the CARES Act. NCGS 105-153.5(c2)(12). The add back amount may then be deducted on the North Carolina individual returns in 5 equal installments beginning in 2021. NCGS 105-153.5(c2)(15).

G. Net Business Interest Deduction. The CARES Act increased the amount of adjusted taxable income that may be offset by net business interest for 2019-2020, from 30% to 50% of taxable income.

However, Session House Bill 1080 requires both corporate and individual taxpayers to “add back” the additional interest expense deduction. N.C.G.S. 105-153.5 (c2)(17).

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Also see

NCDOR Important Notice dated July 20, 2020

“Decoupling Provisions Impacting Individuals”

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PART THREE

Remember!!

**Section 168 and 179 Deduction
Adjustments – Page 9**

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I. SECTION 179 DEDUCTIONS UNDER THE FEDERAL 2018 TCJA

A. Federal Limits

- Section 179 Deduction Limit is \$1,000,000
- Section 179 “Phases Out” for Purchases over \$2,500,000

I. SECTION 179 LIMITS

B. NC Limits – North Carolina

“Decouples” From PATH Act

- \$25,000 Limit
- SB 276 14 (2016)

I. NEW SECTION 179 LIMITS

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And, 2016 SB 276: Section 179
“phase-out” begins at
acquisitions above \$200,000

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NC requires 85% Add Back of Difference between Federal and NC Section 179 Deductions.

But allows 20% deduction of the “add back” amount over the next five (5) years.

II. NO NC SECTION 168 BONUS DEPRECIATION

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SB 276 (JUNE 1, 2016) – PAGE 9

A. Federal Law. The Federal 2015 PATH Act extended the 50% Section 168 Bonus Depreciation for 2015, 2016 AND 2017.

- ❑ 2018 TCJA – possible 100% write-off for certain acquisitions from September 2017 to January 2023.

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B. SB 276 “De-couples” From Federal Section 168 Bonus Depreciation.

SB 276 (2016) did not adopt the Federal Section 168 bonus depreciation rules for North Carolina tax purposes.

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So, the North Carolina rules mandate

- an 85% "add back" for Excess Federal Section 179 and Section 168 Deductions
- with 20% "add back" deductions over the next five (5) years
- But, same tax basis in acquired asset for federal and state tax purposes

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III. Corporation Forfeits its Bonus Depreciation Deduction Upon Converting to An S Corporation.

**Bodford v. North Carolina Department of
Revenue, North Carolina Superior Court, No. 11
CVS 464 (April 10, 2013).**

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IV. NCDOR PLR 2019-2 (NOVEMBER 20, 2019)

Husband Entitled to Depreciation “Add Back” Deductions After Sale of Pass-Through Entity Interest – PLR 2019-2 (November 2, 2019)

V. Bonus Depreciation Deductions of a Transferor Can Be Added to Tax Basis of Transferee: House Bill 14 (2013).

Special rules apply where:

- ❑ property, subject to Section 168 bonus depreciation, is transferred in a nonrecognition event, or
- ❑ where the ownership interests in the owner of property subject to Section 168 bonus depreciation is transferred in a nonrecognition event.

45 If there is a carryover basis transfer

❖ by gift,

❖ by a merger,

❖ by a Section 351 capital
contribution to a corporation, or

❖ by a Section 721 contribution to a
partnership

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➤ the transferee may add any remaining unused 20% "add-back" deductions to the tax basis of the transferred asset,

and

➤ the transferee may then depreciate the new adjusted tax basis in the property over its remaining useful life.

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- For transfers of Bonus Depreciation assets after 2012, in all events,
- The transferor is not allowed any remaining future bonus depreciation deductions associated with the transferred asset.

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NCDOR ANNOUNCEMENT FEBRUARY 21, 2014

However, for **personal income tax purposes**, the transferee gets the basis addition only if the transferor (or the owner in a transferor)

- certifies in writing to the transferee that the transferor (or the owner in a transferor) will not take any remaining future 20% bonus depreciation deductions associated with the transferred asset.

N.C.G.S. 105-134.6A(e).

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- **Note:** *This Notice illustrates the importance of making sure that the transferee receives the certified written certification from the transferor (or its owners) that future bonus depreciation deductions will not be claimed by the transferor (nor by any of its owners).*

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**Point: Ongoing Problems with
Differences In Federal and State
Treatment of Upfront Write-offs**

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Potential NC tax problem where Section 179 or Section 168 property is sold (or transferred in non-recognition event) during the five (5) years after purchase.

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Another Potential NC Problem

- Could you have double or even triple NC add-backs?

Example: Bonus depreciation creates NOL.

Example: Excess Business Loss creates NOL

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Example: Bonus depreciation creates excess business loss which creates NOL (Carry Back or Carry Forward)

PART FOUR

REVIEW OF NORTH CAROLINA ADJUSTMENT TO FEDERAL AGI

I. Add Backs

Here are some of the **Federal AGI additions** that apply for 2020 and thereafter:

1. Interest income from debt obligations of states other than North Carolina. N.C.G.S. 105-153.5(c)(1);
2. Reduction in S corporation shareholder income by virtue of the Federal Section 1374 "built-in-gains" tax. N.C.G.S. 105-153.5(c)(2);

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3. 85% "add back" for excess Federal Section 179 and Section 168 deductions. N.C.G.S. 105-153.5(c)(5);
4. For property sold during the tax year, the amount by which the taxpayer's tax basis for Federal tax purposes exceeds the income tax basis for North Carolina tax purposes. N.C.G.S. 105-153.5(c)(3);
5. Deferred gain on sale of property under Section 1400Z;

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6. For 2020 and 2021, excess business interest deducted on federal return over thirty (30%) percent of taxable income limitation for North Carolina tax purposes;
7. PPP forgiven loan expenses deducted on federal return;
8. Federal NOL carrybacks into 2013-2019 from the 2018, 2019 or 2020 tax years;

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9. Federal excess twenty (20%) percent NOL deduction against taxable income for 2018, 2019 and 2020;

10. For 2018, 2019 and 2020, excess business loss deduction for federal purposes over business loss deduction for North Carolina purposes;

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11. For 2014-2020, federal qualified tuition and educational expense deductions; and

12. For 2020, amount of employer provided payment of education loans.

PART FOUR

REVIEW OF NORTH CAROLINA ADJUSTMENT TO FEDERAL AGI

II. Reductions

Overview of AGI Reductions From Federal AGI Under N.C.G.S. 105-153.5(b).

1. Interest income from U.S. and North Carolina debt obligations. N.C.G.S. 105-153.5(b)(1);
2. Social Security and Railroad Retirement Benefits. N.C.G.S. 105-153.5(b)(3);

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3. Federal and North Carolina retirement benefits that are exempt under the Bailey, Emory and Patton line of cases. N.C.G.S. 105-153.5(b)(5);

4. State and local income tax refunds. N.C.G.S. 105-153.5(b)(4);

5. 20% deduction allowed due to the Section 168 or Section 179 "add back." N.C.G.S. 105-153.5(b)(8);

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6. For property sold during the tax year, a reduction to the extent that the taxpayer's tax basis for North Carolina tax purposes exceeds the income tax basis for federal tax purposes. N.C.G.S. 105-153.5(b)(7);
7. For deferred gain later recognized under Section 1400Z;
8. Amounts included in federal taxable income for certain economic incentives;

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9. For 2021 through 2025, twenty (20%) percent per year of North Carolina disallowed NOL carryback for 2018, 2019 and 2020;

10. For 2021 through 2025, twenty (20%) percent each year of amount of disallowed federal excess business loss deductions; and

11. For 2021 through 2025, twenty (20%) percent each year for North Carolina add back of excess federal NOL deduction against taxable income for 2018, 2019 and 2020.

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PART FIVE

- New 2021 NC Proposed Legislation

II. Senate Bill 105

Here is a summary of the tax provisions in proposed SB 105.

A. Personal Income Tax Proposed Changes:

(i) Tax rates.

Effective as of 1/1/2022, the individual tax rate will drop from 5.25% to 4.99%.

(ii) Increased Standard Deductions.

Effective January 1, 2022, the standard deductions would increase by \$2,000 for Single filers, \$3,000 for head of household filers, and by \$4,000 for Joint filers.

- **B. Business Income Changes.**

Flow-through SALT Cap beginning 1/1/2022:

An S-Corporation or partnership (or entity taxed as such) may elect to pay SALT (state and local tax) at the entity level, instead of the personal level, to avoid the \$10,000 federal cap on SALT deductions on 1040 schedule A.

B. Reduction of C-Corporation tax rates:

- (i) Effective 1/1/2024, the rate will drop from 2.5% to 2.25%.
- (ii) Effective 1/1/2025, the rate will drop from 2.25% to 1.99%.

C. Corporate franchise tax to be simplified:

a. Base of tax.

i. Effective 1/1/2023 (franchise tax for 2023 is reported on the 2022 corporate tax return). The franchise tax bases of 55% of the value of property (NC form schedule E) and investment in tangible property (NC form schedule D) are eliminated. Thus franchise tax would be based on the capital stock base only (NC form schedule C).

Summary of NC Senate Version of HB 334.

1. PPP equivalent relief – JOBS Grant (“Job Opportunity and Business Saving”) The NC Dept of Commerce would administer a grant program. The amount of federal or state subsidy received, capped at \$250,000, would receive a grant of 7.5% of that amount. Thus a maximum benefit of \$18, 750.
2. Decrease personal income tax from a flat 5.25% to a flat 4.99%.

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3. Increase the state form D-400 standard deduction.
4. Creates a state child tax deduction, for those who receive a federal child tax credit.
5. Allows S corporations and partnerships to elect to pay state income tax at the entity level, thereby bypassing the federal \$10,000 cap. Tax is at the individual flat rate. If an S-corp or partnership does this for a nonresident member, they do not need to pay nonresident withholding tax.

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6. Phases out the state C-corporation income tax rate. After 2027 it would be 0%.
7. Corporate franchise tax.
 - i. Eliminates the property in NC and property tax value bases, leaving only the capital stock base.

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PART SIX

- New State Tax Issues for Employees Working Remotely.

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Concerns for the Employee:

- Which State Gets My Taxes Paid To?
- Do I Get A State Tax Credit?

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Concerns for the Employer:

- Nexus?
- Withholding to the Right State.
- Workers Compensation and Unemployment Tax Issues.

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PART SEVEN

- **States Continue to Create Workarounds on Federal SALT Deduction Limits.**

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I. Background

Section 11042 of “The Tax Cuts and Jobs Act,” Pub. L No. 115-97, limits an individual’s deduction under §164 for the aggregate amount of state and local taxes paid during the calendar year to \$10,000.

State and local payments in excess of those amounts are not deductible.

This new limitation applies to taxable years beginning after December 31, 2017 and before January 1, 2026.

76 II.

Second Circuit Rules SALT Limits are Constitutional

In 2018, the states of New York, Connecticut, Maryland, and New Jersey filed a lawsuit arguing that the SALT deduction cap was unconstitutional for a number of reasons.

In September 2019, the federal district court dismissed the lawsuit, holding that the SALT cap was not unconstitutionally coercive and did not interfere with states' rights and sovereignty. The state appealed, and on October 5, 2021, a three-judge panel of the Second Circuit Court of Appeals unanimously affirmed the trial court's dismissal of the states' claims and held that the SALT deduction cap was not unconstitutional. The case citation is New York v. Yellen, No 19-3962-cv, 2021 U.S. App. LEXIS 29862 (2d Cir. Oct. 5, 2021).

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III. States Continue Efforts to Find a “Work-Around”.

A. State Tax Donation Credits Don’t Work.

One common SALT cap workaround that states tried to adopt early on involved classifying state tax donation credits as deductible charitable contributions for federal income tax purposes. The idea was that state legislatures would adopt legislation that would allow taxpayers to make transfers to funds controlled by state or local governments, in exchange for credits against the taxpayer’s state or local income taxes. The goal was to subsequently allow the taxpayer to characterize such transfers as fully deductible charitable contributions on the taxpayer’s federal income tax return.

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This seemed like a quick and easy workaround. Well, the IRS was quick to question this approach when it issued Notice 2018-54 announcing that it would take a substance-over-form approach regarding such transfers. Ultimately, the IRS shot down this idea entirely when it issued Treasury Decision 9864 making it clear that a taxpayer making payments to an eligible state or local entity in exchange for state or local income tax credits, must reduce the amount of the taxpayer's federal charitable contribution deduction by the amount of any state or local tax credit that the taxpayer receives or expects to receive.

B. But, What About a Pass-Through Entity Deduction?

But then the concept of a pass-through entity tax, or PTE Tax, received the Treasury and the IRS blessing via Notice 2020-75 on November 9, 2020.

Under the PTE Tax, the state and local income taxes imposed on a partnership or S corporation's income are paid by the entity directly, rather than the individual owner. Because the SALT cap applies only to personal income taxes, not income taxes paid by businesses, then the SALT cap is lifted for that income. AS a result, the tax payments made by the entity are deductible against the entity's taxable income, thus effectively resulting in a federal tax deduction to the entity's owners.

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The Treasury has still yet to issue regulations to specifically address the PTE Tax, but that has not stopped states from adopting some version of the PTE Tax. At least fourteen (14) states now have an optional or mandatory PTE Tax. North Carolina has proposed a PTE Tax, but nothing has materialized thus far.

The PTE Tax varies slightly from state to state, but in most states like New York and New Jersey, if the entity is subject to, or elects to pay the PTE Tax, then its owners are permitted to claim a credit on their individual state income tax returns for their share of the PTE Tax paid by the entity. In other states like Louisiana, the owners' state taxable income is reduced by the income included on the entity's return.

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PART EIGHT- PAGE 19

- **The U.S. Supreme Court's Decision in Wayfair and the New “Economic Presence” Nexus Test for Sales Taxes for Out-of-State Remote Sellers**

Overview of Wayfair. June 21, 2018, U. S. Supreme Court upheld the constitutionality of a South Dakota nexus statute which required that out-of-state remote sellers collect sales tax if it

- (1) made more than \$100,000 in sales into the state of South Dakota or
- (2) engaged in at least 200 sales transactions with South Dakota residents,

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- regardless of whether or not the remote seller actually had any physical presence in South Dakota and even if it had no assets or employees physically present in the State of South Dakota.

[South Dakota vs. Wayfair, Inc., 138 S. Ct. 2080 (2018)].

- In Wayfair, the Supreme Court overruled its earlier 1992 decision in Quill vs. North Dakota that established the “physical presence” requirement.

- Wayfair now substitutes an “economic presence” test for the “physical presence” nexus test previously in place under the Quill decision.

- At the present time, many states have enacted, or are in the process of enacting, economic presence legislation very similar to the South Dakota legislation that was the subject of the Wayfair case.

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North Carolina Adopts The Economic Nexus Test

- On August 7, 2018, the North Carolina Department of Revenue issued a Directive (S.D. 18-6) adopting the “economic presence” test, effective November 1, 2018.

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2019 Legislation (SB 523) codifies economic presence test and now requires that remote out-of-state sellers:

- having gross sales in excess of \$100,000 sourced in North Carolina
- or two hundred (200) or more separate transactions sourced in North Carolina
- in the previous or current year
- must register, collect and remit sales and use tax

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- Beginning 60 days after the seller meets the threshold amount

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- So, this means that any out-of-state remote seller that met the threshold requirement in 2018 must collect and remit sales and use tax.
- And, once a remote seller has met the threshold for the current year or a future year, it will then have 60 days from that date to register and begin collecting and remitting North Carolina sales tax on sales sourced to North Carolina.

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For instance

If an out of state retailer makes 250 transactions in North Carolina in year 1, 150 in year 2, and 150 in year 3, they would have to collect and remit sales tax in years 1 and 2, but not for year 3.

PART NINE

NORTH CAROLINA SALES AND USE TAX DEVELOPMENTS – PAGE 21

I. HB 97 (2015) Expands the Sales Tax Base To Repair, Maintenance and Installation Services

- **Overview.** Perhaps the most significant (and perhaps the most controversial) change in recent years was the expansion of the sales tax base to include repair, installation and maintenance services **beginning March 1, 2016.**

See new Section 105-164.3(33d).

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PART NINE
NORTH CAROLINA SALES AND USE
TAX DEVELOPMENTS

Work on Real Property

Taxable RMI Services

vs.

Non-taxable Capital Improvements

PART NINE

NORTH CAROLINA SALES AND USE TAX DEVELOPMENTS

Work on Real Property

- When do you charge sales tax?
- When do you pay sales/use tax?

95 **2017 SB 628 ADOPTS NEW N.C.G.S.
105-244.3: “SALES TAX BASE
EXPANSION PROTECTION ACT”**

Page 16

NCDOR shall not assess tax for periods from March 2016 – January 2019 under certain circumstances, such as:

1. Retailer fails to charge sales tax on separately stated installation charges

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**2017 SB 628 ADOPTS NEW N.C.G.S.
105-244.3: “SALES TAX BASE
EXPANSION PROTECTION ACT”**

2. Retailer erroneously treated RMI transaction as a RP Contract
3. Failure to charge sales tax on service contract to maintain TPP attached to real estate

97 2018 TAX CHANGES TO SALES TAX AMNESTY PROVISIONS

4. Taxpayers who failed to collect sales tax on a mixed transaction contract that exceeded 25% of contract price

5. Taxpayers who failed to collect sales tax on the taxable portion of a bundled transaction.

6. A taxpayer who failed to collect sales tax on repair, maintenance and installation services for tangible personal property, motor vehicles or digital property.

2017 TAX ACT

98 ADDITIONAL TAX RELIEF OPTION FOR RMI SERVICES -PAGE 16

If Taxpayer paid sales or use tax on

- Purchase of product
- Used to perform taxable RMI service

Then, taxpayer gets “credit” for sales/use tax
paid

2016 HB 1030 GRANTS SOME OTHER POSSIBLE TAX RELIEF -- PAGE 17

A. New N.C.G.S. 105-237.1(a)(7)

NCDOR may “compromise” tax liability where taxpayer made “good faith” effort to comply where tax assessment involves

1. definition of “retailer” OR
2. expansion of sales tax base to include
 - (i) service contracts
 - (ii) RMI services

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**Applies to tax assessments
for Tax Periods from March
1, 2016 to December 31,
2022**

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□ Query:

How will NC Department of Revenue
apply “good faith” compromise
rules?

How do you show “good faith?”

□ Query:

How will NC Department of Revenue apply “good faith” compromise rules?

➤ When will “Good Faith” Relief Be Applied

- During sales tax audit?
- During Departmental Review Appeals?
- After Final Determination and During Collection?

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PART TEN
CORPORATE INCOME AND
FRANCHISE TAX DEVELOPMENTS

– Page 25

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CORPORATE TAX DEVELOPMENTS

- Net Business Interest Limited to 30% of Taxable Income – Not 50% Under CARES Act
- PPP Loan Forgiveness Expense Deduction

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**STARTING IN 2018,
APPORTIONMENT BASED
SOLELY ON SALES FACTOR**

- But where are sales “sourced” to?

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NC ADOPTS MARKET-BASED SOURCING FOR APPORTIONMENT OF INCOME AND FRANCHISE TAXES

- Session Law 2019-246 (November 8, 2019)
- Beginning in 2020
- Where are products or services delivered to?

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- Service Revenues are “Sourced” to NC if services are delivered to customer in NC.
- Sales of Products are “Sourced to NC” if product is received by purchaser in NC.

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**NEW
NCDOR NOTICE
2020**

- **Six Pages of Sourcing Charts**

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**PART ELEVEN
PARTNERSHIPS AND
S CORPORATIONS - PAGE 28**

- No Pass-Through Composite Required if Non-Resident is Business AND Annual Affidavit Filed with NCDOR every year

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- Partnership doing business in NC (by holding real estate) with 5 of 6 Non-Resident Partners Still Must File North Carolina Return
- PLR 2020-01
- Page 21

NORTH CAROLINA DEPARTMENT OF REVENUE
PROCEDURAL CHANGES

Page 29

I. New Automatic Extension Request for 2019 Tax Returns

- The 2018 Act now provides that any taxpayer who receives an automatic extension of time to file a federal income tax return is granted an automatic extension to file a North Carolina return, as long as the taxpayer certifies on the state tax return that the taxpayer was granted a federal extension.
- **Note:** This Section becomes effective for taxable years beginning on or after January 1, 2019.

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**NEW CHANGES TO CONTRACTOR
WITHHOLDING RULES
SENATE BILL 523 (JULY 26, 2019)**

Pre-existing Law:

N.C.G.S. 105-163.3 requires that any payer paying more than \$1,500 in a calendar year to an ITIN contractor must withhold 4% of income tax on the compensation being paid to the ITIN contractor.

**NEW CHANGES TO
CONTRACTOR WITHHOLDING
RULES
SENATE BILL 523 (JULY 26, 2019)**

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New Changes:

Under amended N.C.G.S 105-163.3, effective January 1, 2020, a payer must deduct and withhold 4% NC income tax from nonwage compensation paid to a "payee" if the payer expects to pay more than \$1,500 to the payee in that calendar year.

DEFINITION OF “PAYEE:”

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- A non-resident contractor that provides a performance, entertainment, athletic event, speech or creation of film, radio or television program here in North Carolina.
- An ITIN contractor, including someone who is applying for an ITIN and someone who has an expired ITIN.

- Any person who performs services in NC who fails to provide the payer a taxpayer identification number.
- A person who performs services in North Carolina that fails to provide the payer a valid taxpayer identification number. (And, for this purpose, the NCDOR must notify the payer that the ITIN is invalid and if that happens, then the withholding requirement only applies to compensation paid to that payee after that date).

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- Only applies if Payer expects to pay more than \$1,500 in one (1) year
- Oct. 18, 2019 NCDOR Directive provides example

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- Payer pays \$900 in January 2020 and does not expect to pay any more in 2020.
 - No tax withholding required.
- Later in 2020, Payer pays \$800 to same contractor.
 - Now Payer must withhold \$32 ($\$800 \times 4\%$)

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- No withholding required for payments to out-of-state corporation or LLC if
 - Registered in North Carolina
 - Payer keeps copy of SOSID of LLC or corporation
 - But, always get Form W-9

Page 23

Possible Personal Liability Under
N.C.G.S. 105-242.2(b)(4)

For Failure to Withhold.

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VI. NCDOR MUST START RECOGNIZING POWERS OF ATTORNEY – PAGE 23

Session Law 2019-246 (November 8, 2019)

- ❑ NCDOR must update electronic data system
- ❑ to send notices to taxpayer and POA at the same time

TRUST FUND RECOVERY AND “RESPONSIBLE PERSONS” – PAGE 30

I. Responsible Person Liability for Trust Fund Taxes

A. Background. Individual officers and directors of a corporation are usually not liable for corporate debts or obligations. General partners of a partnership, on the other hand, are always personally liable for debts and liabilities of the partnership.

B. "Responsible Person" Liability Under N.C.G.S. 105-242.2.

However, by statute, a "responsible officer" of a corporation or a limited liability company may be held personally liable for certain unpaid "trust taxes" owed by the business entity, such as sales and use, motor fuels, and income withholding taxes. A "responsible officer" is defined as any of the following:

- (i) a general partner of a partnership
- (ii) the president, treasurer, and the CFO of a corporation,
- (iii) the manager of an LLC, and
- (iv) any other officer of a corporation or a member of a LLC who has a duty to pay trust taxes on behalf of the entity.

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This is a “Strict Liability” statute.

- Sec. of Rev. Division 2006-145 (February 2007)
- Manager of LLC
- Retail Sales of Clothing
- No authority to collect and remit sales tax
- Not an Owner of LLC

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C. Criminal Exposure for “Aiding and Abetting Embezzlement of State Funds”

- Even if NOT “responsible person”
- H.B. 1080 (2020)

D. New Extended Statute of Limitations on Assessment Against Business

- **Extended From 3 to 10 years**
- **H.B. 1080 (2020)**

III. Could a Responsible Person Be Personally Liable For Uncollected Sales Taxes Or The Failure to Do The 4% Withholding?

Under N.C.G.S. 105-242.2, certain "responsible persons" are personally liable for sales taxes that have not been collected if the person knew, or should have known, that the sales tax was not being collected. N.C.G.S. 105-242.2(b)(2).

IV. Continued Criminal Prosecutions Against Certain Responsible Persons For Diverted Trust Fund Taxes.

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See NCDOR Website under “2020 Press Releases”

- Did these taxpayers use “Trust Funds” to pay
 - Personal expenses of their own?
 - Business expenses for their benefit?
- Who knows,
 - But many of them got active jail time.