



SENATE BILL 19: Revenue Laws Technical Changes

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

2015-2016 General Assembly

Committee:	Senate Finance	Date:	February 23, 2015
Introduced by:	Sens. Rabon, Rucho, Tillman	Prepared by:	Cindy Avrette, Heather Fennell
Analysis of:	PCS to First Edition S19-CSTDx-1		Committee Counsel

SUMMARY: *Senate Bill 19¹ incorporates the Revenue Laws technical changes that were circulated during the 2014 Session in Senate Bill 763, House Bill 1224, and House Bill 189, or some combination thereof. These provisions make technical corrections and clarifying changes to the tax statutes largely based on recommendations of the Department of Revenue. In addition to the changes circulated last session, the bill would make two others changes recommended by the Revenue Laws Study Committee: it clarifies the intent of the General Assembly regarding the impact of the Tax Simplification and Tax Rate Reduction act (S.L. 2013-316) on utility rates and it provides that certain tangible personal property purchased to fulfill a contract with a person who holds a farmer exemption certificate or a conditional farmer exemption certificate is exempt to the same extent as if purchased directly by the person who holds the exemption certificate.*

The Proposed Finance Committee Substitute makes changes to Section 4 of the bill and adds a new Section 24 to the bill. The new section temporarily extends the statute of limitations for a qualified airline employee to file a request for refund of income tax from the recharacterization of an airline payment amount as a rollover contribution to a traditional IRA. A request for refund must be made on or before October 1, 2015. This change ensures that the rollover contributions would be taxed only once and that the application of tax for State tax purposes would conform to its federal tax treatment.

BACKGROUND: After passage of House Bill 1050 early in the 2014 Session, the companion bill, Senate Bill 763, became the primary vehicle for additional revenue laws technical changes and passed the Senate in late July. However, a number of substantive provisions were added to Senate Bill 763 on the House floor, in which the Senate did not concur. The non-roll call changes in Senate Bill 763 were put into House Bill 1224 and the roll call technical changes were put into House Bill 189. Neither of those bills passed. This recommendation of the Revenue Laws Study Committee incorporates those changes into this bill.

EFFECTIVE DATE: Except as otherwise provide, this bill would become effective when the act becomes law.

BILL ANALYSIS:

Section	Explanation and Effective Date
1	This section does two things. First, it clarifies that the changes related to retailer-contractors, which become effective January 1, 2015, are not to be construed to affect the interpretation of any statute that is the subject of a State tax audit for taxable years beginning prior to the effective date of the changes. The prior

¹ As introduced, this bill was identical to H41, as introduced by Reps. Howard, Brawley, Lewis, Setzer, which is currently in House Finance.



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	<p>language referred to "audit pending," which the Department indicated was unclear. The changes made by Part VII of S.L. 2014-3 are not intended to be retroactive, and therefore any audit or litigation resulting derived from an audit for taxable years prior to January 1, 2015 is subject to the statutes and interpretations of the Department for those years.</p> <p>Second, it clarifies the effective date by providing that the changes apply to withdrawals from inventory on or after that date as well as sales since retailer-contractors do both; they make retail sales of items and they withdraw items from inventory that are used in the performance of a real property contract.</p>
2	<p>This section clarifies the conditions under which a retailer is or is not liable for the collection of tax on the rental of private residences rented for fewer than 15 days and listed with a real estate broker during the period in which the Department's Important Notice was in effect and during the 30-day period following the effective date of S.L. 2014-3. The original provision was not specific to the private residence changes but generically referred to the entire section, which could have been interpreted to affect the liability of retailers required to collect tax on the rental of accommodations generally.</p> <p>This section becomes effective June 1, 2014.</p>
3	<p>This section repeals an unnecessary provision; Section 14.1 of S.L. 2014-3 made the same change.</p>
4	<p>The Tax Reduction Act, S.L. 2013-316, included electricity and piped natural gas in the State sales tax base while repealing the utility franchise tax on electricity and the excise tax on piped natural gas. Section 4.2(a) of the Act directed the Utilities Commission to adjust the rates of electricity and piped natural gas to reflect the repeal of the utility franchise tax and the excise tax on piped natural gas. The Act also reduced the corporate income tax rate. However, the Act did not direct the Utilities Commission to take any action on utility rates related to the reduction in corporate income tax rates.</p> <p>In May of 2014 the Commission took its first action related to the Act. The Commission issued an order directing utilities to adjust rates to reflect the repeal of the utility franchise tax, the repeal of the excise tax on piped natural gas, and the reduction in the corporate income tax rate. Dominion Power and PSNC Energy both appealed this order, on the grounds that the Act did not direct the Commission to take action related to the reduction in the corporate income tax rate.</p> <p>In October of 2014 the Commission reversed its first order. The Commission authorized the utilities not to reduce their rates related to the changes in the corporate income tax rate, and allowed any utility that had reduced rates for this reason to recover those funds from customers.</p> <p>No utility has taken this step of seeking to recover these funds from customers. Except for Dominion Power, all of the retail electric and piped natural gas utilities are passing on the savings from the reduction in the corporate income tax rates to their customers.</p> <p>This section would clarify the intent of the General Assembly regarding the impact of the Act on utility rates. This draft would direct the Commission to adjust utility</p>

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	rates to reflect the reduction in the corporate income tax rate and would also direct the Commission to impose interest on any refunds issued to utility customers as a result of reduction in the corporate income tax rate.
5	<p>S.L. 2014-3 enacted a new tax on vapor products as part of the current tax on other tobacco products (OTP). This section makes a technical change that allows North Carolina manufacturers of vapor products to collect the new vapor tax on internet retail sales, while allowing the manufacturers to continue to the current practice of applying to the Secretary of Revenue to be relieved of the tax for vapor products shipped to wholesale and retail dealers. The Secretary allows manufacturers to be relieved of paying the tax on OTP when the tax is paid by the wholesale or retail dealer.</p> <p>This section becomes effective June 1, 2015.</p>
6	<p>This section clarifies that the credit may be taken when the property is placed into service in this State. When a renewable energy project is put together, there are usually two sets of investors, those that want the federal credit and those that want the State credit. If the lessee is to get the federal credit, it must "place it into service". However, if the lessor wants the State credit, it must "place it into service". As clarified by this section, the lessor may claim the State credit as long as somebody (the lessee) places the property into service.</p>
7	<p>This section incorporates a revision made to G.S. 15-130.5(b)(4) made by Section 14.3 of S.L. 2014-3 so that the changes engross correctly in the codification process.</p>
8	<p>This section clarifies that the phrase "subject to tax under Part 2 or 3 of Article 4" applies to a beneficiary of a transferor.</p> <p>Subsection (a) becomes effective for the 2013 taxable year; subsection (b) becomes effective for the 2014 taxable year.</p>
9	<p>This section provides that neither an individual nor a withholding agent may be penalized for underpayment of income tax for the 2014 taxable year if the reason for the underpayment is the clarification of the law in S.L. 2014-3. S.L. 2014-3 clarified that a person who is not eligible for a federal standard deduction is not eligible for a State standard deduction. A nonresident alien individual is not allowed a standard deduction. This section does not change the effective date of the substantive law change or the amount of tax due and payable.</p>
10	<p>This section clarifies that the term "retailer" is any person required to collect sales tax imposed under G.S. 105-164.4, other than a facilitator. The current definition does not reflect the expansion of the sales tax base to prepaid meal plans, admission charges, piped natural gas, and service contracts.</p>
11	<p>This section makes technical and conforming changes.</p>
12	<p>This section clarifies that the exemption provisions applicable to fuel also include piped natural gas. PNG is considered fuel, but since the imposition of the combined rate of tax for PNG is separate from the general tax imposed on fuel, the Department of Revenue requested this clarifying change.</p>
13	<p>This section does four things. First, it would clarify that a farmer is allowed a sales and use tax exemption for farm-related purchases if the farmer's sales plus other</p>

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	<p>amounts used to determine farm income under the Code exceeds \$10,000. Under current law, the farmer's gross income may be reduced by the farmer's basis of livestock. Under this section, gross sales of livestock would not be reduced by the cost or basis of the livestock sold.</p> <p>Second, it would clarify that the exemption expires <i>upon the earlier of</i> the following: when a person fails to meet the income requirement for three consecutive years or ceases to engage in farming operations. And a new farmer may obtain a conditional exemption provided the person submits applicable income tax returns to the Department <i>and provided</i> the person is engaged in farming operations.</p> <p>Third, it would make a similar clarifying change as made in Section 11 of this bill for the farm exemption for fuel and piped natural gas. It also makes other technical changes suggested by the Department of Revenue.</p> <p>Fourth, it would provide that certain tangible personal property purchased to fulfill a contract with a person who holds a farmer exemption certificate or a conditional farmer exemption certificate is exempt to the same extent as if purchased directly by the person who holds the exemption certificate.</p> <p>This section becomes effective July 1, 2014. A contractor who paid sales and use tax on an item exempt from sales and use tax, as enacted by this section, may request a refund from the retailer and the retailer may, upon issuance of the refund or credit, request a refund for overpayment of tax under G.S. 105-153.3.</p>
14	<p>This section does two things:</p> <ul style="list-style-type: none">• It provides that a retailer who has an agreement with a food service contractor to collect and remit the sales tax on gross receipts derived from a prepaid meal plan is not liable for the tax that the retailer remits to the food service contractor.• It requires a retailer to report gross receipts derived from a prepaid meal plan on an accrual basis of accounting for purposes of reporting sales tax.
15	<p>This section makes a change as to who may apply for a certificate of registration for legal entity so that it is consistent with the changes made in Section 14.18 of S.L. 2014-3 as to who may be liable for unpaid sales tax for a legal entity.</p>
16	<p>This section changes a statute that was not codified as it was intended to be amended by Section 47 of S.L. 2013-414. The section does not change the substance of the subdivision. The change made last session codified the Department's administrative practice of allowing protective refund claims to be filed when an event prevented a taxpayer from having the information necessary to file a request for refund, such as pending litigation or an ongoing income tax audit in another state that may affect the taxpayer's NC tax liability.²</p>
17	<p>Part XI of S.L. 2014-3 established a procedure for the central assessment of mobile telecommunications property. The intent of this Part was to shift the responsibility for conducting the valuations of this particular kind of property from the individual</p>

² Generally speaking, there is a time limit within which a taxpayer may file a claim for refund. If the claim for refund is not timely filed, it will be barred. The Department has administratively allowed for a taxpayer in these circumstances to file a timely but incomplete claim for refund, known as a "protective refund claim," and then later perfect the claim when the essential information becomes available.

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	<p>counties to the Department of Revenue without creating any "winners" or "losers" in terms of the values allocated to the counties. This section makes minor modifications to that Part to ensure that there is no shifting of value among counties as a result of the change.</p> <p>The Department appraises this property at its "true value," which includes consideration of its original cost but with deductions made for all forms of depreciation to arrive at the property's fair market value. However, under S.L. 2014-3, the allocation of the value among the counties in which the property is located would have been based only on original cost. Using original cost would have had the effect of overinflating the value allocated to a particular county and decreasing the value allocated to other counties. This section provides that once the Department determines the value of the property, it will be allocated among the counties based on where the property is located.</p>
18	<p>Cities have historically been prohibited from imposing a license, franchise, or privilege tax on certain utility-related businesses, such as telecommunications, video programming, and electricity. With the repeal of G.S. 160A-211, effective July 1, 2015, the specific prohibition language would also be repealed.</p> <p>While cities only have the power to tax or charge a fee to the extent the legislature has granted them the authority to do so, and the repeal of this prohibition is not necessarily a grant of authority otherwise, the utilities industry has concerns about the deletion of the prohibition as it relates to rights-of way and has requested that the language be kept in the statutes. This section recodifies the language in a more appropriate place in the statutes.</p>
19	<p>S.L. 2013-316, included electricity and piped natural gas in the State sales tax base while repealing the utility franchise tax on electricity and the excise tax on piped natural gas. A portion of both of the repealed taxes was shared with the cities. The tax-sharing revenue under the repealed taxes was replaced with a distribution of part of the sales tax on electricity and piped natural gas. This section clarifies that funds from the sales tax may be used for the final distribution of the repealed franchise tax on electricity and repealed excise tax on piped natural gas.</p>
20	<p>This section conforms to federal law, and codifies the current practice, of providing the same standard deduction amount for a surviving spouse as for a married couple filing jointly. Subsections (a) and (b) make the necessary changes to the tax statutes effective for taxable years beginning on or after January 1, 2014. Subsections (c) and (d) make the same change for taxable years 2012 and 2013. When North Carolina used federal taxable income as its starting point, a specific reference to "surviving spouse" was not necessary because the amount of the standard deduction was automatically a part of that calculation. However, with the change in the 2012 taxable year to federal adjusted gross income, this conforming provision was inadvertently omitted.</p>
21	<p>This section removes a reference to a repealed statute, and incorporates the definition that was referenced in the repealed statute.</p>
22	<p>Subsection (a) of this section would remove reference to a repealed statute and clarify in the personal income tax statutes that income of a partnership that is apportionable to multiple states is allocated and apportioned in accordance with G.S.</p>

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	<p>105-130.4. Income that is not apportionable should be allocated to the appropriate state. The current statute refers to a ratio rather than to the rules of allocation and apportionment.</p> <p>For State income tax purposes, subsection (b) of this section would require S Corps, partnerships, estates and trusts to add back State income tax that was deducted from federal income. Prior to S.L. 2013-316, the statutory requirement for the add-back for S Corporations, partnerships, estates and trusts was a cross reference to the individual requirement. When the individual requirement was repealed, add-back for S Corporations, partnerships, estates and trusts requirement was erroneously repealed as well.³</p> <p>This section becomes effective for taxable years beginning on or after January 1, 2015.</p>
23	<p>Subsection (a) of this section would clarify that the exemption for items used to maintain or repair tangible personal property applies to those items used pursuant to a service contract subject to sales tax. If the service contract is not subject to tax, then the item used to maintain or repair the property is subject to tax. Subsection (b) of this section would make a conforming change in Article 5F regarding the treatment of items used in a service contract. These subsections would become effective when the act becomes law.</p> <p>Subsection (c) of this section would provide that the exemption applies, regardless of when the service contract was purchased. It would be difficult for a person to know, when a service is performed pursuant to a service contract, whether the service contract was purchased before or after January 1, 2014.</p>
24	<p>This section temporarily extends the statute of limitations for a qualified airline employee to file a request for refund of income tax from the recharacterization of an airline payment amount as a rollover contribution to a traditional IRA. A request for refund must be made on or before October 1, 2015. The extension would mean that State tax law conforms to federal tax law.</p> <p>The FAA Modernization and Reform Act of 2012 provided a qualified airline employee who previously made a qualified rollover contribution of an airline payment amount to a Roth IRA could recharacterize all or a portion of it as a rollover contribution to a traditional IRA by transferring the funds from the Roth IRA to a traditional IRA in a trustee-to-trustee transfer. Federal law allowed an airline employee who recharacterized a Roth rollover contribution to exclude from gross income the airline payment amount previously rolled over to the Roth IRA for the tax year in which the employee received the airline payment amount from the commercial passenger airline. The airline employee who recharacterized the Roth IRA contributions is allowed to seek a refund of taxes attributable to the inclusion of the airline payment amount in income. Congress extended the time an airline</p>

³ This requirement was repealed for individual filers in S.L. 2013-316, when the itemized and standard deduction was changed for individual filers.

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	<p>employee had to claim a refund to April 15, 2013. In December 2014, Congress extended this time period for two years, April 15, 2015.⁴</p> <p>Although State income tax law conforms to the federal tax law provisions allowing the airline employee to recharacterize their Roth IRA contributions, the State's statute of limitations has expired, thus preventing the employee from filing a request for refund. This section would extend the State's statute of limitations in a very limited manner to allow an airline employee to seek a refund of taxes attributable to the inclusion of the airline payment in income. Without this change, the rollover amounts contributed would have been taxed at the State level, as would the subsequent distributions. The purpose of this section is to prevent the double taxation of the amounts.</p> <p>To receive a refund under this section, a taxpayer must make a request for refund by October 15, 2015. A refund request received after this date is barred. The number of taxpayers impacted by this provision is unknown but it is expected to be only a few.</p>
25	Except as otherwise provided, this act is effective when it becomes law.

⁴ The rule allowing employees of airlines to rollover payments received following the airline's bankruptcy had expired before American Airlines and its parent corporation (AMR) sought bankruptcy protection in 2011. The company filed a federal bankruptcy case on November 29, 2011, and froze its defined benefit plans on November 1, 2012.