



SENATE BILL 729: Various Changes to the Revenue Laws.

2015-2016 General Assembly

Committee:		Date:	September 13, 2016
Introduced by:		Prepared by:	Greg Roney Staff Attorney
Analysis of:	S.L. 2016-5		

OVERVIEW: *S.L. 2016-5 makes various changes to the Revenue Laws including the following changes with broader impact:*

- *Limits the qualified interest expense deduction for interest paid to a related corporation to 15% (from 30%) of a corporate taxpayer's adjusted taxable income and allows an unlimited qualified interest expense deduction if the corporate taxpayer can trace the interest expense to a unrelated lender.*
- *Restores a miscellaneous itemized deduction applicable when individual taxpayers 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.*
- *Adds a deduction for individual taxpayers who report business income on a Schedule C to equalize treatment of individual taxpayers and corporate taxpayers reporting ordinary and necessary business expenses where the expense was taken as a tax credit for federal purposes.*
- *Provides that individual taxpayers must adjust federal adjusted gross income to prevent a double benefit of the federal net operating loss (NOL) carryover.*
- *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.*
- *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.*
- *Disallows the State government sales tax exemption and sales tax refund of local taxes paid on indirect purchases for occupational licensing boards and State governmental entities that are specifically designated to apply for a sales tax refund under G.S. 105-164.14.*

This act became effective May 11, 2016; however, most sections have an effective date based on the tax reporting period for the type of tax. Please see the full summary for additional detail.

Section	Bill Analysis	Effective Date
PART I: BUSINESS TAX CHANGES		
1.1	Repeals the annual franchise or privilege tax on mutual burial associations. The Department of Revenue collected \$750 in franchise tax on mutual burial associations in 2014. The General Assembly repealed most of the State	Taxes due on or after 4/1/17

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	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. Makes conforming changes to delete reference to repealed statute.	
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.	Taxable years beginning on or after 1/1/16
1.4	Corrects a statutory reference.	When law
1.5	Clarifies that an exercise of the royalty reporting option by a taxpayer does not affect whether the taxpayer has nexus and does not permit receipts to be excluded from the calculation of the sales factor.	When law
1.6	Excludes from the definition of "sales" that determine how much of a multistate corporate taxpayer's income is subject to tax in NC the following: (1) financial swaps and other similar financial derivatives and (2) certain receipts in the nature of dividends. Therefore, these transactions will not affect how much income is taxable in NC.	Taxable years beginning on or after 1/1/16
1.7	Corrects the effective date in Section 32.15.(g) of S.L. 2015-241 and Section 10.1(i) of S.L. 2015-268 which made changes to the corporate franchise tax base. The effective date was 1/1/17 and taxes due after 1/1/17. However, short-year 2016 tax returns would compute the 2017 franchise tax because the corporate franchise tax under G.S. 105-122 is computed on the basis of the books of the corporation as of the close of its income year. The corrected effective date will be for taxable years beginning on or after January 1, 2017. This effective date will apply the franchise tax base modifications to all franchise tax reported on the 2016 income and franchise tax return regardless of when the tax return is due.	When law
1.8(a)	Makes the definition of deductible interest expense paid between parent and subsidiary corporations consistent for in-State and out-of-State companies. The technical change makes the definitions parallel and clarifies the treatment of consolidated returns.	Taxable years beginning on or after 1/1/16
1.8(b)	Limits the qualified interest expense deduction for interest paid to a related corporation to 15% (from 30%) of a corporate taxpayer's adjusted taxable income and allows an unlimited qualified interest expense deduction if the corporate taxpayer can trace the interest expense to a unrelated lender.	Taxable years beginning on or after 1/1/16
1.9	Corrects the effective date for the deduction to prevent double taxation of income. The American Recovery & Reinvestment Act of 2009 in Internal Revenue Code section 108(i)(1) permitted an individual or a corporate taxpayer	Taxable years beginning

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	<p>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.</p> <p>Sections 1.9, 2.1, and 2.4 of this bill address the State tax treatment of Internal Revenue Code section 108(i)(1).</p>	<p>on or after 1/1/09 Time barred refund claims allowed until 7/1/16 by section 6.1</p>
PART II: PERSONAL TAX CHANGES		
2.1(a)	<p>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.</p>	<p>Taxable years beginning on or after 1/1/14</p>
2.1(b)	<p>Adds a deduction to prevent double taxation of income. The American Recovery & Reinvestment Act of 2009 in Internal Revenue Code section 108(i)(1) 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.</p> <p>Sections 1.9, 2.1, and 2.4 of this bill address the State tax treatment of Internal Revenue Code section 108(i)(1).</p>	<p>Taxable years beginning on or after 1/1/14 Time barred refund claims allowed until 7/1/16 by section 6.1</p>
2.1(c)	<p>Adds a deduction to equalize treatment of corporate taxpayers and individual taxpayers who report business income on a Schedule C. Corporate taxpayers may deduct ordinary and necessary business expenses for State purposes where the expense was taken as a tax credit for federal purposes under G.S. 130.5(b)(11). This section adds the same deduction (i.e., deduct business expenses for State purposes where a federal credit was taken in lieu of a deduction) for individual taxpayers. This deduction existed for individual taxpayers under repealed G.S. 105-134.6(d)(2). 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.</p>	<p>Taxable years beginning on or after 1/1/16</p>
2.2(a)	<p>Provides that an individual taxpayer must adjust federal adjusted gross income to prevent a double benefit of the federal net operating loss (NOL) carryover.</p>	<p>Taxable years</p>

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	<p>NC 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.</p>	<p>beginning on or after 1/1/16</p>
2.2(a)	<p>Provides that an individual taxpayer must add the amount deducted in a prior taxable year if the amount was withdrawn from the Parental Savings Trust Fund of the State Education Assistance Authority and not used for qualified higher education expenses unless the withdrawal was made without penalty under section 529 of the Code due to the death or permanent disability of the designated beneficiary. 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.</p>	<p>Taxable years beginning on or after 1/1/16</p>
2.3	<p>Corrects a statutory reference and removes obsolete language.</p>	<p>When law</p>
2.4	<p>Adds a deduction to prevent double taxation of income. The American Recovery & Reinvestment Act of 2009 in Internal Revenue Code section 108(i)(1) 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.</p> <p>Sections 1.9, 2.1, and 2.4 of this bill address the State tax treatment of Internal Revenue Code section 108(i)(1).</p>	<p>Taxable years beginning on or after 1/1/09</p> <p>Time barred refund claims allowed until 7/1/16 by section 6.1</p>
<p>PART III: SALES TAX CHANGES</p>		
3.1	<p>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.</p>	<p>When law</p>
3.2(a)	<p>This subsection removes obsolete definitions and updates the statutory reference to the Streamlined Sales Tax Agreement.</p>	<p>When law</p>
3.2(b)	<p>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".</p>	<p>1/1/17</p>
3.3	<p>Corrects a statutory cross-reference.</p>	<p>When law</p>

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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.	When law
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.	When law
3.7	Replaces a term with the defined term.	When law
3.8	<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.</p> <p>Sales tax applies to tangible personal property sold below cost with a contract. Under prior law, sale tax applied to the presumed sales price if the service in the contract was not taxable; and it applied to the part of the presumed sales price paid by the consumer if the service in the contract was taxable. The presumed sales price is the retail price at which the item would sell in the absence of the service contract. The prior law did not address the situation where part of the service was taxable and part of it was not. For example, a mobile phone contract may include not only taxable telecommunications service but also internet access service that is not taxable. This section 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. It provides that the presumed sales price of the item is equal to the percentage of the service in the contract that is not taxable. It also makes a conforming change to the local sales tax base to clarify that the local sales tax applies to the presumed sales price.</p>	When law
3.9	<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.</p>	1/1/17
3.11	Corrects a statutory reference and clarifies that fuel and piped natural gas exempt from sales tax (because it is sold to a manufacturer for use in connection with the operation of a manufacturing facility) remains taxable if it is used solely for comfort heating at a manufacturing facility where there is no use of fuel or piped natural gas in a manufacturing process.	1/1/17
3.12(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	When law

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	as well as the holder of a qualifying farmer exemption certificate.	
3.12(b)	Corrects a statutory reference.	When law
3.14	Repeals an obsolete provision.	When law
3.15	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. There is no statute of limitations when a taxpayer fails to file a return.	When law
3.16	Adds "data" to the types of records the Secretary of Revenue may examine.	When law
3.17(a)	Makes changes necessitated by the Streamlined Sales and Use Tax Agreement. The change will allow certified service providers adequate time to make changes to their systems. This section also allows the Department to make adjustments as needed to the tax matrix used by certified service providers.	When law
3.17(b)	Changes the timing of any local tax rate increase from 2 months after the adoption of the tax increase to the calendar quarter after a minimum of 60 days' notice to sellers.	When law
3.18	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.	When law
3.19	This section clarifies that a park model RV is a recreational vehicle and is subject to the highway use tax. Under current law, it has been unclear whether a park model RV is subject to sales tax or highway use tax.	7/1/16
3.20	Clarifies that the white goods tax applies to any new white good purchased for storage, use, or consumption in this State.	7/1/16
3.21	Clarifies that the net proceeds of the One-Quarter Cent Local Option Sales Tax is allocated to the taxing county.	When law
3.22	Disallows the State government sales tax exemption and sales tax refund of local taxes paid on indirect purchases for (i) occupational licensing board and (ii) State governmental entities that are specifically designated to apply for a sales tax refund under G.S. 105-164.14. 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 and the NC State Board of Certified Public Accountants are occupational licensing boards under that definition. As such, these entities would no longer be eligible for the State sales tax exemption.	7/1/17

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3.23	Clarifies that the exemption for aviation gasoline and jet fuel applies to commercial aircraft in interstate or foreign commerce. The change adds "foreign commerce" to allow the exemption to apply where commercial aircraft fly directly to another country from NC. The effective date is retroactive to match the effective date of the enactment of the exemption.	1/1/16
3.24	Clarifies the sales tax exemption for service contracts on transmissions, engines, rear-end gears, and any other items purchased, leased, or rented by a professional motorsports racing team.	Applies retroactively to 1/1/14
PART IV: EXCISE TAX CHANGES		
4.1	Conforms the bonding requirements for entities that must pay excise tax on cigarettes and tobacco products. 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.	When law
4.2	Clarifies the applicability of the tax on other tobacco products (OTP) to specify that the OTP rate does not apply to cigarettes that are taxed at 45¢ per pack and does not apply to vapor products that are taxed at 5¢ per mL of consumable product.	When law
4.3	Authorizes wine shippers to file excise tax returns on shipments once a year, rather than monthly. Sections 4.3 and 4.12 address wine shipper permittee filing annual reports.	When law
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. In Section 4.4(c), the phrase "prior to" is replaced with "after." The change allows severance producers to post a bond or irrevocable letter of credit after obtaining a permit under G.S. 113-395. The Department of Revenue requested this change to avoid a situation where the Department holds bond indefinitely until the producer receives the required permit.	When law
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. 	When law

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4.6	Conforms the statutes for temporary trip permits for motor carriers to the current Department practice.	When law
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.	When law
4.8	Clarifies the interest rate applicable to IFTA taxpayers.	When law
4.9	Restores the calculation of the cost per gallon of motor fuel used when a taxpayer receives a refund of the motor fuel excise tax less the sales tax on the motor fuel. S.L. 2015-2 (Senate Bill 20) changed the calculation of the motor fuels excise tax rate. Conforming changes were made to the calculation of the tax refund on motor fuels excise tax. The conforming changes continued to authorize a refund of motor fuel excise tax less sales tax but omitted a method to calculate an average cost per gallon. Section 4.9 restores the method to calculate the average price per gallon of motor fuel. Prior to S.L. 2015-2, the calculation method used "average wholesale price." Section 4.9 follows S.L. 2015-2 and uses the Consumer Price Index Detailed Reports published by the Bureau of Labor Statistics of the United States Department of Labor for retail sales of motor fuels. The Department of Revenue requested this section.	1/1/16
4.10	Corrects cross references	1/1/16
4.11	The 2015 Budget Bill phased out the Noncommercial LUST Fund. Subsection (a) of this section clarifies the legislative intent by specifically providing that any revenue allocated from the ½ cent per gallon for various funds that is not distributed is to be distributed with the remaining excise tax revenue. Effectively, that means the 3/32 percent of the ½ cent per gallon revenue that is currently allocated to the Noncommercial LUST will be distributed to the Highway Fund and the Highway Trust Fund, effective with FY16-17. Subsection (b) of this section clarifies that distributions of the excise tax revenue to the Noncommercial LUST fund will be discontinued, beginning with FY16-17. For accounting purposes, the current date of June 30 creates ambiguity for the Department of Revenue as to how to distribute the funds from that one day's collections.	7/1/16
4.12	Makes conforming changes to G.S. 105-113.84 to allow wine shipper permittees to file an annual report. Sections 4.3 and 4.12 address wine shipper permittee filing annual reports.	When law
PART V: OTHER TAX CHANGES		
5.1	Extends the time period for which the Department may transfer an assessment against a responsible person.	When law
5.2	Repeals an obsolete statute.	When law
5.3	Repeals an antiquated statute in Chapter 131E, Public Hospitals, and puts the provisions pertaining to the taxability of public hospitals in the tax statutes,	When law

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	<p>Chapter 105. The antiquated statute refers to repealed taxes and contains a blanket statement that the authority is exempt from all taxes.</p> <p>In practice, hospitals apply for a refund of sales and use tax paid under 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. This section exempts interest income from bond obligations from corporate and individual income tax and exempts motor fuel purchased by a hospital authority created under G.S. 131E-17.</p>	
5.5	<p>Replaces incorrect cross-references with the applicable wage, health insurance, and environmental impact standards, as they formerly existed in G.S. 105-129.83. Article 3J tax credits sunset for taxable years beginning on and after January 1, 2014. To be eligible for a tax credit under Article 3J, a taxpayer had to meet certain wage, health insurance, and environmental impact standards. Those standards were found in G.S. 105-129.83. Several grant programs and the sales tax exemption for qualifying datacenters refer to those standards.</p>	When law
PART VI: EFFECTIVE DATE		
6.1	<p>General effective date is when act becomes law.</p> <p>Authorizes a tax refund even if barred by the statute of limitations (G.S. 105-241.6(a)) for a taxpayer that had an amount added to taxable income as deferred income under section 108(i)(1) of the Internal Revenue Code and the amount would be excluded under Sections 1.9, 2.1, or 2.4 of this bill. A request for a refund must be made on or before July 1, 2016.</p>	<p>When law</p> <p>Time barred refund claims allowed for IRC sec. 108(i)(1) until 7/1/16</p>

Cindy Avrette and Trina Griffin substantially contributed to this summary.