SENATE BILL 628:
Various Changes to the Revenue Laws.

2017-2018 General Assembly

Committee:	Senate Finance. If favorable, re-refer to Rules and Operations of the Senate	**Date:**	May 23, 2017
Introduced by:	Sens. Tillman, Brock, Tucker	**Prepared by:**	Cindy Avrette Staff Attorney
Analysis of:	PCS to First Edition S628-CSRBxr-15		

OVERVIEW: The Proposed Committee Substitute for Senate Bill 628 makes various technical, clarifying, and administrative changes to the revenue laws, many of which have been recommended by the Department of Revenue.

AMENDMENT: The amendment would make the following changes:

- Helps reconcile the sales and use tax refund allowed to interstate carriers with the recent legislative changes to the sales tax base by including service contracts other than motor vehicle service contracts as well as repair, maintenance, and installation services.
- Removes three provisions from the bill: (i) the provision that would have increased the criminal penalty for attempt to evade or defeat tax from a Class H felony to a Class C felony for violations that involved $100,000 or more; (ii) the provision that would have increased the criminal penalty for subsequent offenses of willful failure to file return, supply information, or pay tax from a Class 1 misdemeanor to a class H felony; and (iii) the provision giving the Secretary of Revenue discretion as to what constitutes a separate offense.
- Changes the effective date for identity theft to December 1, 2017.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE (as amended):

Section	Bill Analysis	Effective Date
PART I. BUSINESS TAX CHANGES		
1.1	Removes unnecessary language in the franchise tax statutes.	When it becomes law
1.2	Recognizes that a holding company may own companies that do not own stock	When it becomes law
1.3	Allows taxpayers to reduce tangible property base for franchise tax purposes by the amount of any debt owed on the property. The adjustment was eliminated in the 2015 franchise tax simplification changes. The section also modernizes the statute.	Taxable years on or after Jan. 1, 2018
1.4	Specifies that a transferor of the historic tax credit for restoring non-income producing property must provide the transferee with information detailing	Taxable years on or

	the rehabilitation expenses and the credit amount	after Jan. 1, 2017
1.5	Subsection (a) clarifies that petroleum-based liquid pipeline companies apportion income for corporate income and franchise tax based upon the number of barrel miles transported in this State. This change codifies existing practice. The subsection also modernizes the statute. This subsection becomes effective for taxable years beginning on or after January 1, 2017. Subsection (b) changes the apportionment method for gas pipeline companies to a method based upon the cubic foot of gaseous property transported in this State. This subsection becomes effective for taxable years beginning on or after January 1, 2018, if market-based sourcing is enacted, as passed by the Senate in Section 38.7(a) of Senate Bill 257. If market-based sourcing is not enacted, then the current apportionment method used by gas pipeline companies will remain unchanged.	Various effective dates
1.6	Modifies corporate income tax deduction for interest expense paid or accrued to affiliates. Under current law, a corporation may deduct the greater of an amount limited to 15% of its adjusted taxable income or its proportionate share of interest paid or accrued by the affiliated group to an unrelated party. However there is no limitation on the deduction under certain conditions, such as if the recipient is subject to state tax on the interest income. The bill eliminates the 15% provision. The bill also clarifies that if one of the conditions is met, the Department cannot disallow the deduction by applying one of the rules of the regulations under Section 385 of the Internal Revenue Code.	Taxable years on or after Jan. 1, 2017
1.7	Corrects a statutory cross-reference	When it becomes law
1.8	An out of state owner in an S corporation or partnership is subject to North Carolina tax on the pro rata share of income attributable to North Carolina. This section clarifies that this amount includes guaranteed payments received in addition to profit distributions. The change is made to all taxable years.	Various effective dates
1.9	Same as above. The change is made to all taxable years.	Various effective dates
1.10	Makes modifications to the gross premiums tax applicable to captive insurance companies to combat tax avoidance via captive insurance company arrangements.	Taxable years on or after Jan. 1, 2017
PART II. SALES AND USE TAX CHANGES		
Last biennium, the General Assembly expanded the sales tax base to repair, maintenance, and installation (RMI) services. The Department of Revenue worked with Finance chairs, legislative staff, and interested parties to implement those sales tax changes. Sections 2.1 through 2.8 of this Part make technical, clarifying, and minor substantive changes to the sales tax applicable to RMI services and real property contracts.		

2.1	Moves definitions from G.S. 105-164.4H into the sales tax definition statute, G.S. 105-164.3. The following definitions have been amended to provide greater clarity: • Capital improvement. – Simplifies the definition and treats lessees of property the same as property owners. It also clarifies that painting provided as part of a repair, maintenance, and installation service is part of that service. • Free-standing appliance. – A new defined term. A free-standing appliance is tangible personal property and remains TPP once installed. It is taxable as TPP. There is a sales tax exemption for installation charges that are part of the sale price of TPP purchased by a real property contractor to fulfill a real property contract. GS 105-164.13(61c). • Landscaping. – Clarifies that landscaping modifies living elements. It does not include hardscape or services to items in pots or buildings. Provides that landscaping, by definition, is a capital improvement, and taxed accordingly. • Mixed transaction. – Clarifies that it is a contract for a capital improvement as well as a repair, maintenance, or installation service unrelated to the capital improvement. • Motor vehicle service contract. – Clarifies that the term includes a contract sold by a motor vehicle dealer on behalf of a motor vehicle service company. • Remodeling. – Clarifies the definition by using the language more similar to the language contained in the Department's directives and notices. The definition gives examples of transactions where the true purpose of the transaction is a repair, maintenance, and installation service. • Repair, maintenance, and installation service. – Clarifies that the term includes the installation of an item being installed to replace a similar existing item when the replacement is not part of a capital improvement.	Effective Jan. 1, 2017
2.2	Clarifies that a sale of a free-standing appliance is a retail sale of tangible personal property. Removes an imposition that is unnecessary because the tax treatment of an item purchased by a real property contractor to fulfill a real property contract is addressed in G.S. 105-164.4H; provides a cross-reference to this tax treatment in G.S. 105-164.4(a)(16).	Effective Jan. 1, 2017
2.3	Clarifies the sourcing of services.	Effective Jan. 1, 2017
2.4	Makes changes to the statute that addresses the taxation of real property contracts. A transaction is taxable as a repair, maintenance, and installation service unless a person substantiates that the transaction is subject to tax as a real property contract. Subsections (a) and (b) of this section make the	Effective Jan. 1, 2017

	following changes to G.S. 105-164.4H: • G.S. 105-164.4H(a) and (b): Removes "services" because a real property contractor does not owe sales tax on services; the term should have been removed when the General Assembly removed the tax distinction between retailer-contractors and real property contractors. • G.S. 105-164.4H(a1): Adds a new subsection to clarify that a transaction involving services to real property is a retail sale unless the person substantiates that a transaction is a real property contract. Provides that a person may substantiate a transaction as a real property contract by records or by receipt of an affidavit of capital improvement. A person who receives an affidavit of capital improvement is not liable for any additional tax due on transaction if the transaction is not a capital improvement. • G.S. 105-164.4H(b1): Repeals this subsection re: liability for unpaid sales and use taxes because the liability for unpaid taxes is already addressed in G.S. 105-164.6. • G.S. 105-164.4H(d): Makes a substantive change to mixed transactions by increasing the percentage of RMI services that may be taxed as part of a capital improvement from 10% of the contract price to 25% of the contract price. • G.S. 105-164.4H(e): Repeals this subsection because the definitions are moved to the definition statute, GS 105-164.3. Subsection (c) of this section revises G.S. 105-164.6 to include any necessary language from the repealed G.S. 105-164.4H(b1). The liability provisions need to be in one statute to avoid confusion and to ensure consistent tax treatment. Subsections (d) and (e) of this section make technical and clarifying changes to related statutes. Repeals subsection (e) of G.S. 105-164.4H because the definitions are moved to the definition statute.	
2.5	Moves the transactions that are exempt from the sales tax on service contracts from G.S. 105-164.4I(b) to the sale tax exemption statute, G.S. 105-164.13. Clarifies that a contract to provide a certified operator for a wastewater system is not a taxable service contract.	Effective Jan. 1, 2017
2.6	Consolidates the sales tax exemptions into the sales tax exemption statute, G.S. 105-164.13. Clarifies that property or services used to fulfill a RMI service or a service contract remains taxable if the service or service contract is exempt from tax. Limits the exemption for services provided incidental to an inspection to motor vehicle inspections.	Effective Jan. 1, 2017

	Exempts inspection reports prepared by a person who is required to obtain a State privilege license under G.S. 105-41: professional engineer, architect, landscape architect, real estate appraiser, and home inspector. Clarifies that the exemption includes services required to prepare that report. Removes the exemption for (i) landscaping services and (ii) services performed to resolve an issue that was part of a real property contract because both transactions are defined as a capital improvement. This change does not represent a substantive change. Currently, the items are listed as both an exemption and as a capital improvement.	
2.7	Clarifies that the sales tax refund provided for interstate carriers applies to not only TPP but also RMI services and service contracts other than motor vehicle service contracts. The effective date for this section is retroactive to the date RMI services became subject to sales tax.	March 1, 2016
2.8	Subsection (a) of this section allows a seller who paid sales tax on a product and used the product as part of a taxable RMI service, to offset the sales tax liability on the service with the sales tax paid on the products. This provision helps contractors and subcontractor who purchased items used in a taxable service prior to January 1, 2017, and who purchase items during the transitional period. Subsection (b) of this section directs the Revenue Laws Study Committee to study the feasibility of providing such an option on an on-going basis.	Effective Jan. 1, 2017, and expires July 1, 2018
2.9	Makes several technical and clarifying changes to the sales tax statutes, as requested by the Department.	When it becomes law.
2.10	Provides that Sections 2.1 through 2.8 of this Part are effective retroactively to January 1, 2017. If any change made by these sections increases a sales or use tax liability, that change is effective when this act becomes law. The remainder of this section is effective when it becomes law.	When it becomes law.
PART III. TAX COLLECTION AND ENFORCEMENT		
3.1	Creates a new crime for identify theft in the tax statutes. Currently, a person may be prosecuted for identity theft under Article 19C of Chapter 14 of the General Statutes. Under G.S. 14-113.20, an element of the crime is that the person must represent themselves as another person. Under Article 19C, identity theft is punishable as a Class G felony; it is punishable as a Class F felony if the person is in possession of identifying information pertaining to three or more persons. The new crime created by this section would not require the person to represent themselves as another person; it would be sufficient if the person fraudulently utilized identifying information of another person in a submission to the Department of Revenue to obtain anything of value, benefit, or advantage for themselves or another. Also, each person's identity obtained, possessed, or used would count as a separate offense. The crime of identity theft under the tax statutes would be punishable as follows: • Class G felony (maximum punishment of 47 months)	December 1, 2017.

	• Class F felony (maximum punishment of 59 months) if a person suffers any adverse financial impact as a result of the identity theft.	
3.2	Requires a payment settlement entity (financial institutions) that submits credit card information to the IRS to also submit the information to the Department of Revenue. DOR requests this change to improve audit and examinations. Also requires electronic filing for reports submitted to the Department. Failure to file a timely report is subject to a $1,000 penalty.	When it becomes law.
3.3	Provides that taxes, debts, fines, penalties, or other obligations or amounts payable to a governmental unit are not voidable transactions under the Uniform Voidable Transactions Act.	When it becomes law.
PART IV. ADMINISTRATIVE CHANGES		
4.1(a)	Makes a conforming change because of a change enacted last year related to a taxpayer's request for a refund. If the Department determines that the taxpayer's request for a refund is outside the statute of limitations, the Department will issue a notice of denial. Under prior law, the taxpayer could only dispute the denial in superior court. In 2016, the General Assembly changed the law to allow a taxpayer whose claim for refund is denied because it was filed after the statute of limitations passed to appeal the determination before the Office of Administrative Hearings. A final decision by the administrative law judge on the denial is subject to judicial review. With this change, there are two kinds of "denials" issued by the Department subject to administrative review – a proposed denial of a refund claim and a denial of a refund claim when the basis for the denial is a determination by the Department that the claim is outside the statute of limitations. When the Department denies a taxpayer's claim for refund under either basis, it must send the taxpayer a notice. This subsection adds language to the notice requirement to reflect both kinds of denial.	When it becomes law
4.1(b)	Requires a taxpayer to provide an explanation for the basis of the taxpayer's request for review of a proposed denial of a refund or a proposed assessment of tax. This explanation, however, would not prevent the taxpayer from raising other grounds for objecting to the Department's proposed denial of refund or proposed assessment during the conference process. Adds clarifying language regarding a request for review of a failure to pay penalty. Under current law, a taxpayer who does not request review of a proposed assessment may not request review a failure to pay penalty based on that assessment. This provision clarifies that the failure to penalty is issued on a subsequent date in another notice.	See "Effective date" explanation below
4.1(c)	Provides for situations where the Department requests additional information from a taxpayer who has requested review of a proposed denial of a refund or a proposed assessment, and the taxpayer makes no response. If a taxpayer makes no response to the Department's request for additional information, the Department will send a final notice indicating that the proposed denial of	See "Effective date" explanation below

	a refund or the proposed assessment will become final 10 days from the date of the notice. Once final, a proposed denial of a refund or a proposed assessment is not subject to further administrative or judicial review, and the Department may proceed with collection efforts. Conforming changes are found in Section 4.1(d) and Section 4.2(a).	
4.1(d)	Clarifies that one of the possible actions by the Department in response to a taxpayer's request for review is that the Department may adjust the amount of the tax due or a refund owed. Clarifies that if a taxpayer requests review but thereafter pays the amount due, the Department may accept payment and take no further action on the request for review, unless the taxpayer states in writing that he or she wishes to continue the review. A situation like this may occur when a taxpayer wants to stop the accrual of interest on a proposed assessment. Under current law, when a taxpayer files a request for review, the Department can take one of three actions: (1) grant the refund or remove the assessment; (2) schedule a conference with the taxpayer; or (3) request additional information from the taxpayer. This subsection reworks the statute but effectively maintains the substance of the current law. Under the bill, the three actions that could be taken by the Department are: (1) grant the refund or remove the assessment; (2) adjust the amount of the tax due or refund owed; or (3) request additional information. If none of these actions, or payment by the taxpayer of the amount owed, resolves the taxpayer's objections, then the Department would schedule a conference with the taxpayer.	See "Effective date" explanation below
	Effective date - For the above three subsections, which deal with changes to the request for review process, the effective date is when it becomes law. The provisions would apply to requests for review filed on or after that date and to pending requests for review. However, for pending cases, the Department must reissue a request for additional information, if one has previously been issued, allow the taxpayer time to respond, and notify the taxpayer that failure to respond will result in the matter becoming final and subject to collection efforts.	
4.1(e)	Changes the term "taxpayer" to "party" thereby allowing either a taxpayer or the Department of Revenue to appeal a decision of OAH to the Superior Court of Wake County. This change reflects current practice as described in the background below. The statutory framework for the administrative and judicial review of actions by the Department with respect to claims for refund and proposed assessment were substantially overhauled in 2007. Prior to 2007, these matters were heard before a hearing officer within the Department with the ability to appeal to the Tax Review Board. The 2007 rewrite changed the process to give taxpayers an independent hearing outside the Department. Under the current process, if a taxpayer and the Department are unable to resolve matters informally and internally, a taxpayer can file a contested case with the Office of Administrative Hearings, which can be further appealed to superior court.	Retroactive to January 1, 2012

	As part of the rewrite, G.S. 105-241.16 was revised to reflect these changes, providing that a ***taxpayer*** aggrieved by the decision in a contested case could appeal to Superior Court. It did not make any provision for the Department to appeal to Superior Court because of the way OAH decisions were handled at that time. Prior to 2011, OAH could only issue a "recommended decision." The decision was referred back to the originating agency, and the agency would issue a "final decision" that could be appealed to superior court. The authority to issue a final decision included the ability to change OAH's decision. Therefore, as a practical matter, when G.S. 105-241.16 was originally drafted in 2007, the Department would not have needed the authority to appeal to superior court because the Secretary could reverse an unfavorable OAH decision.[1] In 2011, the General Assembly changed the law to allow OAH to issue final decisions. G.S. 150B-43 was changed to state, "Any ***party or*** person aggrieved by the final decision in a contested case…is entitled to judicial review…"; previously, the statute only said "person." The change recognized that agencies, as well as aggrieved citizens, could seek judicial review of OAH final decisions. However, when this change was made, no corresponding change was made to G.S. 105-241.16, which also provides for judicial review of OAH decisions, but specifies that those cases must be heard in Business Court. The Department believes that the failure to make a conforming change to G.S. 105-241.16 in 2011 was an oversight and that it currently has authority under G.S. 150B-43 to appeal cases to Superior Court and are currently doing so. An interpretation otherwise would mean the Department of Revenue is one of the only, if not *the* only, agencies that may not seek judicial review of an adverse OAH decision, making OAH the final arbiter of tax cases in which the Department is the aggrieved party. Because the Department believes this is essentially a technical change, it has requested a retroactive effective date of January 1, 2012, which is the date the 2011 legislation, allowing OAH to render final decisions, became effective. It is worth noting that there is an ongoing lawsuit involving a sales and use tax assessment in which the taxpayer is alleging that the court lacks subject matter jurisdiction to hear the case based on G.S. 105-241.16.	
4.3 – 4.6	Changes terminology throughout the various excise tax statutes to clarify the license cancellation and revocation process and changes the term "license holder" to "licensee" throughout. Specifically, Section 4.3 makes these changes to the tobacco products statutes; Section 4.4 makes these changes to the motor carrier statutes; and Sections 4.5 and 4.6 make these changes to the motor fuel tax statutes. Makes two additional changes in the motor carrier statutes. Changes the term "registration" to "licensure" to be consistent with the International Fuel Tax Agreement (IFTA) which uses the term "licensing" throughout all of the IFTA manuals, and also to differentiate between "registering for the vehicle	When it becomes law

[1] NC Department of Revenue v. First Petroleum Servs. Inc.

	plate" which is completed through DMV or IRP. Adds the phrase "used in connection with any business endeavor" in G.S. 105-449.47 to make the statutory language consistent with the IFTA Articles of Agreement, which specifies that in order to qualify as a recreational vehicle, the vehicle shall not be used in conjunction with any business endeavor. Tobacco products dealers/distributors, motor carriers, and motor fuels suppliers, importers, and distributors are required to obtain a license from the Department of Revenue. There are circumstances under which the Secretary may "summarily cancel" a license, which means the Secretary cancels the license ***prior*** to holding a hearing on the matter, or the Secretary may "cancel" a license, which occurs only ***after*** holding a hearing. The term "cancel" is also used to refer to when a licensee voluntarily requests the cancellation of his or her license because, for example, the licensee is no longer engaging in business in the State. These sections change the terminology so that the term "cancellation" would refer only to an action taken by the Secretary upon a voluntary surrender, and the term "revocation" would refer to a "for cause" situation based on the noncompliance factors outlined in statute.	
4.7	Amends the confidentiality statute to allow the Department to provide State tax information that relates to noncustodial parent location information to the Office of Child Support and Enforcement of the Department of Health and Human Services as required under federal law. This agreement to share information has previously existed with DHHS through a memorandum of understanding but has since expired. The provision is needed to be compliant with an IRS audit. Both Departments are in agreement to the provision.	When it becomes law
PART V. PROPERTY TAX		
5.1	Makes two changes to the Tax and Tag Program. The change made in subdivision (2)a. reflects the way the system is currently programmed. The change works best for counties and taxpayers. The changes made in subdivisions (2)d. and e. allows counties to bill only once a year, and charge the same amount of interest on unregistered vehicles as on registered vehicles. It treats vehicles the same, whether they are registered or unregistered with DMV.	Taxable years on or after July 1, 2017
5.2	Corrects a statutory reference.	When it becomes law.
5.3	Clarifies that all public service companies are treated the same when the value to a taxing unit amounts to less than $500.	When it becomes law.
PART VI. EFFECTIVE DATE		
	Except as otherwise provided, this act is effective when it becomes law.	