



# HOUSE BILL 1079: Various Sales Tax Changes.

2019-2020 General Assembly

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<b>Committee:</b>		<b>Date:</b>	June 11, 2020
<b>Introduced by:</b>		<b>Prepared by:</b>	Trina Griffin Staff Attorney
<b>Analysis of:</b>	S.L. 2020-6		

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**OVERVIEW:** *S.L. 2020-6 has three parts consisting of various sales and use tax changes:*

- *Part I of the act provides relief to auctioneers and estate sale companies in light of recent law changes. The expansion of the sales tax exemption for the purchase of certain animals by qualifying farmers contained in this Part becomes effective July 1, 2020. The remainder of this Part became effective June 5, 2020.*
- *Part II of the act expands the scope of the sales and use tax exemption for equipment purchased by a large fulfillment facility. This provision becomes effective July 1, 2020, and applies to sales occurring on or after that date.*
- *Part III of the act makes the following changes with respect to the sales tax on digital property:*
  - *Clarifies that the provision of an "educational service" by certain institutions, regardless of whether all or a portion of the instruction is delivered through an online class, whether live or recorded, is not a taxable event.*
  - *Exempts sales of digital audio works and digital audiovisual works that qualify as an educational expense when purchased by the operator of a homeschool.*
  - *Exempts sales of digital audio works and digital audiovisual works that consist of nontaxable service content when the transfer occurs contemporaneously with the provision of the nontaxable service in real-time.*

*This Part is effective retroactively to October 1, 2019, and applies to sales occurring on or after that date.*

## PART I: AUCTIONEERS AND ESTATE SALES

**CURRENT LAW & BACKGROUND:** Auctioneers who buy or acquire tangible personal property by consignment or otherwise that they sell at retail must register with the Department of Revenue and collect and remit sales tax on the sales. This longstanding principle has remained unchanged for many years, but the passage of the marketplace facilitator provision has resulted in a re-examination of some aspects of this industry. As the Department sought to notify and educate the auctioneer industry about recent law changes, it became apparent that there is some inconsistency among auctioneers with respect to understanding their sales tax collection obligations. One area of confusion relates to the auctioning of livestock. While there is a sales tax exemption for "products of the farm," the exemption only applies if the *seller* of the farm products, which includes animals, is the producer – meaning the farmer. Those same farm products sold by an auctioneer are subject to tax. Another exemption that comes into play is when the *purchaser* is a qualifying farmer. If the purchaser meets the definition of a qualifying farmer and presents an exemption certificate at purchase, then the auctioneer is not required to collect tax, but the

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only animals exempt in this situation are baby chicks and poults. These exemptions may account for some of the inconsistency or confusion within the industry.

Another reason for the lack of clarity among auctioneers may be attributable to a Departmental interpretation from the early 1990s providing that an auctioneer is not liable for collecting and remitting sales tax when tangible personal property is sold for the owner at the owner's location. This interpretation applied to both estate sales conducted at an owner's home or farm and to sales of fixtures and equipment belonging to a retail or wholesale business that was going out of business when the sale was conducted on-site at the business' location.<sup>1</sup> The Department has previously opined that, in these circumstances, the auctioneer is acting as an agent for the owner of the property and, therefore, steps into the shoes of the owner who would otherwise not have to collect sales tax on the casual and isolated sale of the owner's household possessions or fixtures and equipment that were not ordinarily sold in the course of its business. Moreover, when an auctioneer conducts a sale on the owner's property, the auctioneer never takes possession of the goods.

Against this backdrop, the General Assembly passed the marketplace facilitator provision in November 2019, with a February 1, 2020, effective date. The marketplace facilitator provision, by its very terms, makes a person who sells a third-party seller's items through a forum or marketplace operated by that person and who collects payment for those goods, a retailer required to collect sales tax. This effectively made certain auctioneers or operators of estate sales, retailers who are required to collect sales tax regardless of the fact that the sale may be held at an owner's location. Because the focus of the marketplace facilitator provision was primarily large online retailers who conduct third party sales, like Amazon, eBay, and Etsy, there was little discussion about the impact on the auctioneer/estate sale industry, and business owners who previously were not required to collect sales tax in these situations had a short period of time to come into compliance.

**BILL ANALYSIS:** Part I of the act does three things:

- It expands the sales tax exemption with respect to the purchase of certain animals by qualifying farmers to include livestock. "Livestock" is defined to mean cattle, sheep, goats, swine, horses, and mules. The current exemption applies only to baby chicks and poults.
- It authorizes the Secretary of Revenue to compromise the liability of an auctioneer with respect to the sale of livestock at auction for which the auctioneer failed to collect sales tax if the taxpayer can demonstrate a good faith effort to comply with the tax laws, which would include being registered as a retailer by July 1, 2020. This ability to compromise liability would apply only to tax due for a reporting period ending prior to July 1, 2020. This provision recognizes that there may have been some confusion or lack of clarity in the auctioneer industry with respect to sales tax collection obligations and gives the Secretary flexibility in the event an auctioneer is assessed for failure to collect. However, by no later than April 1, 2020, all auctioneers will have been notified by the Department, through both email and regular mail, as to their registration and collection obligations.
- It provides an eight-month grace period<sup>2</sup> (1) to businesses that conduct tag sales or estate sales at either a person's home or farm and (2) for auctions of fixtures and equipment that were held for use by a retail or wholesale business when the sale is conducted at the business location without risk of assessment by the Department for failure to collect tax. The intent is to afford these businesses who previously did not have to collect tax in these situations with additional time to

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<sup>1</sup> This interpretation did not apply to retail sales of inventory held for resale.

<sup>2</sup> From February 1, 2020, to October 1, 2020.

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come into compliance with the marketplace facilitator provision that became effective February 1, 2020.

**EFFECTIVE DATE:** The expansion of the sales tax exemption for qualifying farmers who purchase livestock becomes effective July 1, 2020, and applies to sales occurring on or after that date. The remainder of the changes became effective June 5, 2020.

## **PART II: LARGE FULFILLMENT FACILITIES**

**CURRENT LAW AND BACKGROUND:** In 2017, the General Assembly enacted a sales and use tax exemption for certain equipment purchased by a "large fulfillment facility." A large fulfillment facility is a facility used primarily for receiving, inventorying, sorting, repackaging, and distributing finished retail products for the purpose of fulfilling customer orders.

To qualify, the facility must invest at least \$100 million in real and tangible personal property within five years of the first property investment, as certified by the Department of Commerce, and must maintain an employment level of 400 people. There is a forfeiture provision in the event the employment level at the facility drops below 400.

Examples of equipment used in the distribution process would include automated storage and retrieval systems, conveyor and sortation systems, storage systems, racking and mezzanine systems, automated packaging systems, labeling and scanning equipment, and forklifts and other powered equipment.

At the time the legislation was being considered, the types of businesses that were considered to be the primary beneficiaries of the exemption were businesses like Amazon or Walmart. However, there are other types of fulfillment facilities. One example would be Publix, which is in the process of building a distribution center in Greensboro and that will fulfill orders for their various grocery stores. The existing exemption would not cover some types of equipment used at its fulfillment center.

**BILL ANALYSIS:** Part II of the act expands the sales tax exemption for equipment, accessories, attachments, and repair parts purchased by a large fulfillment facility to include the following:

- When these items are purchased by a contractor or subcontractor if the purchase is for use in the performance of a contract with the facility.
- Equipment used for baling previously used packaging for resale, sanitizing as required by federal law, and material handling.

This Part also provides a limited refund provision in the event a large fulfillment facility makes purchases of this equipment prior to July 1, 2020, when the exemption became effective.

**EFFECTIVE DATE:** The expansion of the sales tax exemption under this Part becomes effective July 1, 2020, and applies to sales occurring on or after that date. The refund provision became effective on June 5, 2020.

## **PART III: CLARIFY DIGITAL PROPERTY/ONLINE LEARNING**

**CURRENT LAW:** North Carolina taxes the sale of the following digital property that is accessed or delivered electronically:

- Audio work – A series of musical, spoken, or other sounds, including a ringtone.
- Audiovisual work – A series of related images and any sounds accompanying the images that impart an impression of motion when shown in succession.
- A book, magazine, newspaper, newsletter, report, or another publication.

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- Photograph or greeting card
- Digital codes used to purchase any of the above products.

**BACKGROUND:** Last year, the General Assembly made a change with respect to the taxation of digital property by removing language in the statute that said, in order for digital property to be taxable, the item "*would be taxable...if sold in a tangible medium.*" This change arose from a private letter ruling (PLR) request received by DOR in 2011. The taxpayer provided access to an online video catalog of continuing education courses for which users could take an exam at the conclusion of the course and receive a completion certificate. Because the taxpayer did not provide a tangible version of these videos, the Department concluded the videos were not taxable.

However, the outcome of this PLR was inconsistent with the plain meaning and intent of the statutory language. Because the statute stated that these items were taxable to the extent they "*would* be taxable...*if* sold in a tangible medium," there was no requirement that the digital item actually exist in a tangible form.

[Section 3.1\(b\) of S.L. 2019-169](#) deleted the phrase from the statute and had the effect of taxing the types of videos mentioned in the PLR, effective October 1, 2019, because they are not unlike any other video sold in a tangible format, which is taxable.

After this change was made, UNC inquired whether it was intended to have any impact on their online classes since, from a definitional standpoint, the terms "audio work" and "audiovisual work" could technically be interpreted to include live-streamed or pre-recorded videos of online classes and presentations. The change made in S.L. 2019-169 was not intended to tax online classes provided to enrolled students by educational institutions. In this context, the "transaction" is the provision of education, which North Carolina does not tax, rather than the sale of a digital good.

While it seems relatively clear that a "traditional" online class offered in an academic or vocational context is more like education and less like the sale of a digital good, that line is not always clear given the complexities and varieties of digital offerings. It is becoming more and more common for digital property to be used as the method for transmitting or conveying the performance of a service. For example, an exercise class, a music lesson, or a financial planning consultation may all be conducted via a live "Zoom" or other streaming platform. Technically, a "Zoom" meets the definition of a "digital audiovisual work," but in this context, the primary purpose or essence of the transaction is the performance of the service; the format is incidental. Moreover, North Carolina doesn't currently tax those services and federal law precludes taxing the digital or online version of the same "in-person" transaction. However, once that content is recorded and sold in a format that a person can watch whenever and as often as they'd like, it becomes a digital good or product, which North Carolina has traditionally taxed.

**BILL ANALYSIS:** Part III of the act does the following:

- Clarifies that the delivery of instruction or training by a public or private K-12 school or an institution of higher education, which includes public and private universities and colleges, community colleges, proprietary schools, and religious schools, to an enrolled student or as part of vocational training, regardless of whether it is conducted online in a live or pre-recorded format, is a nontaxable "educational service" and is not the sale of digital property.
- Exempts sales of audio works or audiovisual works to operators of home schools if the work is a qualifying educational expense under G.S. 115C-595(a)(3).
- Exempts sales of digital audio works or digital audiovisual works that consist of nontaxable service content when the transfer occurs contemporaneously and in real-time with the provision of the nontaxable service. Examples would include an exercise class, a music lesson, or a financial

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planning seminar live-streamed via Zoom. However, pre-recorded or on-demand webinars would be taxable like any other video.

- Establishes a grace period under which the Department of Revenue may not assess a person for any sales and use tax due for the period of October 1, 2019, through August 1, 2020, with respect to the sale of the following types of digital audio works or digital audiovisual works:
  - Those works that consist of continuing education instruction approved or required by an occupational licensing board.
  - Those works that consist of professional development instruction for school board members, administrators, or staff.

**EFFECTIVE DATE:** This Part is effective retroactively to October 1, 2019, to align with the effective date of the digital property change in S.L. 2019-169.