SENATE BILL 174:
Rev. Laws Tech., Clarifying, & Admin. Chngs.

2023-2024 General Assembly

Committee:	House Rules, Calendar, and Operations of the House	**Date:**	March 14, 2023
Introduced by:	Sens. P. Newton, Perry, Rabon	**Prepared by:**	Finance Team: Trina Griffin, Greg Roney and Nick Giddings
Analysis of:	Fourth Edition		

OVERVIEW: SB 174 makes various technical, clarifying, and administrative changes to the revenue laws as recommended by the Department of Revenue.

CURRENT LAW, BILL ANALYSIS, & EFFECTIVE DATES:

Section	Explanation	Effective Date
PART I. CORPORATE AND INDIVIDUAL INCOME TAX CHANGES		
1.1	Updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from April 1, 2021, to January 1, 2023. North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[1] The General Assembly determines each year whether to update its reference to the Code.[2] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes. This year, there are no substantial federal changes and no fiscal impact.	When law.
1.2	Corrects a statutory cross reference.	When law.
1.3	Clarifies that the statutory method of dividing income between states for multistate partnerships and S Corporations also applies to sole proprietorships. G.S. 105-153.4(d) requires S Corporations and	When law.

[1] North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation … shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would be invalidated as an unconstitutional delegation of legislative power."

	partnerships ("pass-through entities") to follow the same rules as multistate corporations for dividing income among states. The Department of Revenue currently requires multistate sole proprietorships to follow the same rules as multistate pass-through entities. New G.S. 105-153.4(d1) codifies the Department of Revenue's current practice in statute. New G.S. 105-153.4(d1) tracks the language of G.S. 105-153.4(d) treating all unincorporated entities the same.	
1.4	Clarifies that the tax credits for income taxes paid to other states by individuals under G.S. 105-153.9 are not refundable. G.S. 105-153.9(a) allows an individual who is a state resident a tax credit for income taxes paid to another state or country on income that is also taxed by the State. The clarification was a result of the tax credits allowed for the SALT cap workaround (discussed in section 1.6 of this bill) and the possibility that taxpayer's paying entity-level tax in another state would claim tax credits greater than the individual's State tax liability.	When law.
1.5(a)	Makes a conforming change requiring tiered partnerships that are taxed at the entity level to pay tax on behalf of nonresident partners. G.S. 105-153.9(c) requires partnerships to pay estimated tax on behalf of a nonresident partner. Partnerships that elect to pay entity-level tax under the SALT cap workaround do not pay estimated tax under G.S. 105-153.9(c). However, Section 1.5(b) of this bill allows tiered partnerships to elect to pay entity-level tax under the SALT cap workaround. Tiered partnerships are partnerships where a partner is another partnership. A conforming change was necessary to limit the exemption from estimated tax for taxed partnerships to require estimated tax if the partnership is a tiered partnership.	Effective for taxable years beginning on or after January 1, 2022.
1.5(b)	Adds partnerships and S corporations to the permissible owners of a partnership electing to be taxed at the entity level for the SALT cap workaround. Current law does not allow a partnership to elect to be taxed at the entity level if a partner is another partnership (called a tiered partnership) or is an S corporation.	Effective for taxable years beginning on or after January 1, 2022.
1.5(c)	Makes a conforming change to remove tiered partnerships from the tax calculated at the entity level because the tiered partnership will pass through its income items (or make an election to be taxed at the entity level).	Effective for taxable years beginning on or after January 1, 2022.
1.5(d)	Allows a deduction for taxes paid by a partnership to another state under new G.S. 105-153.9(d). This deduction allows a partner to deduct taxes paid to another state where the partnership elected to pay entity-level tax in the other state (i.e., electing to use the other state's SALT cap workaround) but did not elect to pay tax in NC. Current law allows a deduction for taxes paid to another state if the tax was paid by an individual in NC and the other state or if the tax was paid by an entity electing to pay tax at the entity level in both NC and the other state.	Effective for taxable years beginning on or after January 1, 2022.

	New G.S. 105-153.9(d) applies where there is a mismatch: partnership pays in the other state but individual pays in NC. New G.S. 105-153.9(e) provides the same deduction for S Corporations as new G.S. 105-153.9(d) provides for partnerships. However, under current law, G.S. 105-131.8 allows shareholders of S Corporations an identical credit for the same tax paid. New G.S. 105-153.9(e) was added to place the deduction for partnerships and S Corporations in the same statute. The last sentence of new G.S. 105-153.9(e) states that a taxpayer claiming a deduction under this subsection may not also claim a credit under G.S. 105-131.8.	
1.6(a)-(f)	<u>SALT Cap Workaround Background</u>: The SALT cap workaround allows pass-through entities to elect to pay the State income taxes at the entity level, which is not subject to the federal state and local tax (SALT) cap of $10,000. The 2017 Tax Cuts and Jobs Act (TCJA) imposed a $10,000 cap on the amount of SALT individual taxpayers can deduct on their federal returns. Typically, pass-through entities such as partnerships and S Corporations allocate business income to the owners' individual income tax returns, which is subject to the SALT cap. In proposed regulations, Notice 2020-75, the Internal Revenue Service and the Department of the Treasury signaled their approval of a workaround that allows the pass-through entity to pay the state income taxes at the entity level, which is not subject to the SALT cap. This workaround allows the owners to avoid the SALT cap on the taxes paid by the entity. The workaround only works for shareholders and members of S Corporations, partnerships, and LLCs treated as partnerships for federal income tax purposes. <u>SALT Cap Workaround Modifications for 2023 and after</u>: Section 1.6 of this bill modifies the calculation of the entity-level tax in NC by excluding income from the entity-level tax calculation. The impact to the SALT cap workaround is non-NC sourced income is no longer included in the taxable income of the entity. The North Carolina Association of Certified Public Accountants (NCACPA) requested the changes to the SALT cap workaround.	Effective for taxable years beginning on or after January 1, 2023.
1.6(a)	Repeals parts of 5 statutes that are no longer needed under the modified SALT cap workaround.	Effective for taxable years beginning on or after January 1, 2023.
1.6(b) 1.6(e)	Makes the election to be taxed at the entity level irrevocable. Section 1.6 of this bill opens the SALT cap workaround to a larger pool of taxpayers including unlimited tiered partnerships. The election was made irrevocable to prevent disruption to a large number of taxpayers if one entity flipped its election and the change cascaded through multiple entities.	Effective for taxable years beginning on or after January 1, 2023.

1.6(c)	Modifies G.S. 105-153.5(c3) to move from 1 deduction system to a system with 2 deductions for owners of pass-through entities making an election to be taxed at the entity level.	Effective for taxable years beginning on or after January 1, 2023.
1.6(d)	Denies a tax credit for taxes paid to another state under G.S. 105-153.9 where a taxpayer deducted the income under the 2 deduction system of G.S. 105-153.5(c3). Makes conforming change to remove reference to statutes repealed by section 1.6(a) of this bill.	Effective for taxable years beginning on or after January 1, 2023.
1.6(e)	See discussion at section 1.6(b) of this bill.	Effective for taxable years beginning on or after January 1, 2023.
1.7	Adds the penalty for failure to timely file an informational return to the list of penalties waived due to a presidentially declared disaster. Current law waives penalties for failure to pay, failure to file, and failure to obtain a license during the time filing a federal return or report or for paying a federal tax is extended because of a presidentially declared disaster.	Effective when law and applies to presidentially declared disasters occurring on or after that date.
PART II. SALES TAX CHANGES		
2.1	Codifies the current administrative provision for determining when utensils are "provided by a retailer" in order to meet the definition of prepared food. Food is taxed as "prepared food" if it is sold with eating utensils provided by the retailer. Years ago, questions arose from retailers as to whether "provided by" means that utensils are physically handed to customers or that utensils are made available in the establishment. In response, the Streamlined Sales Tax Agreement created an administrative provision that states could elect to adopt to clarify and provide consistency with regard to this phrase. The provision establishes a threshold based on sales of prepared food. • If over 75% of the retailer's sales of food is prepared food, then "provided by" means the retailer only has to make utensils available.	When law.

	• If 75% or less of the retailer's sales of food is prepared food, then the food item in question is taxed as prepared food only if the retailer physically hands utensils to the customer. The Department has had this administrative provision in its Sales and Use Tax Bulletin for at least 15 years. This section would put the same provision into the statutes.	
2.2	Authorizes the Secretary to treat a person as a marketplace facilitator where the person does not otherwise meet the definition when the Secretary finds it necessary for the efficient administration of the sales tax. The Secretary has identical authority with regard to treating a person as a retailer when they do not otherwise meet the definition. Historically, the Secretary has only used this authority at the request of and when there is an agreement with a taxpayer.	When law.
2.3	Allows a marketplace facilitator who pays sales and use tax on an item for which the marketplace seller also collected sales and use tax to take a credit on its sales and use tax return to recover the tax paid so that both parties are not remitting tax on the same transaction. This authority currently exists for a retailer who pays sales and use tax on an item that is subsequently resold, but the law is ambiguous with regard to whether a marketplace facilitator may take the credit because, in that circumstance, an item is technically not being "resold."	When law.
2.4(a)	Corrects a cross-reference based on a change made in last year's budget. In 2022, the General Assembly removed off-highway refunds from G.S. 105-449.107 to a newly created G.S. 105-449.106(d). The intent of the change was only to modify the frequency of filing but not make any substantive changes with respect to the exceptions to the sales tax exemptions for off-highway refunds for alternative fuels.	Retroactively to January 1, 2023, and applies to applications for refunds submitted on or after that date.
2.4(b)	Codifies the Department's administrative interpretation of the nonprofit sales tax exemption to allow up to 6 annual sales periods per year provided they do not overlap, and the products must be delivered to purchasers within 60 days after the first solicitation of any sale made during the organization's annual sales period.	When law.
2.5	Updates the reference date to the Streamlined Sales Tax Agreement.	When law.
PART III. EXCISE TAX CHANGES		
3.1	Clarifies the taxation status of synthetic nicotine consistent with Departmental advice to taxpayers.	When law.
3.2	Clarifies the definition of "cost price" and the Secretary's authority to use an alternative means to determine the value of items subject to tax	When law.

	when the taxpayer cannot produce documentation as to the cost price of taxable items. Certain tobacco products are taxed at the "cost price" of the product. Cost price is defined to be either the actual price paid for an item, or if the actual price is not available, it is the average of the actual price paid over the last 12 calendar months. The "average" alternative is intended to provide the Department with a mechanism to calculate the tax when the taxpayer has insufficient records, but it is not intended to implicitly allow a taxpayer to fail to keep accurate records. The Department proposes moving this alternative from the definition to the statute that allows the Secretary to determine a taxpayer's tax liability if the taxpayer has failed to keep adequate records.	
3.3	Removes the requirement that the Secretary note on a tobacco products license whether it is a duplicate or an amended license. This requirement was adopted when tobacco licenses were perpetual, but now, since they are renewable, there is little value to the Department in noting whether the license is duplicate or amended.	When law.
3.4	Removes the filing requirement for delivery sellers that sell only tax-paid product. Generally, the administration of the taxation of tobacco products focuses on non-tax-paid product. Once the tax has been paid, the interest to the Department is significantly reduced and, therefore, it does not need these filings.	When law and applies to filings due on or after that date for sales made during the previous month.
3.5	Aligns record retention requirements for tobacco product licensees and persons required to file reports with the applicable statute of limitations period. Currently, the statute requires a person who is required to keep records under the Article to preserve them for three years. However, it is not clear when the clock begins to run on the three-year period. Moreover, the statute doesn't address the record retention period for taxpayers who either (1) file a return after the due date of the return; or (2) pay a tax years after the due date of the return and subsequently file for a refund. This section provides that records must be preserved for the applicable statute of limitations period, or if the transaction for which records must be kept is not required to be reported in a return, for three years from the date of the transaction.	When law and applies to records for transactions occurring on or after that date.
3.6	Removes the license requirement for delivery sellers that only sell tax-paid product. The rationale for this change is the same as for removing the filing requirement in Section 3.4.	When law.
3.7	Removes the requirement for delivery sellers or remote sellers to maintain records if they are not required to be licensed. Generally, the	When law.

	Department only requires persons who are required to be licensed to maintain records.	
3.8(a)	Removes the license requirement for delivery sellers or remote sellers that only sell tax-paid product. The rationale for this change is the same as for removing the filing requirement in Section 3.4.	When law.
3.8(b)	Establishes a separate tobacco license for vapor products for the purpose of assisting with Master Settlement Agreement (MSA) reporting and aligning licensing requirements with filing requirements. Currently, wholesale dealers and retail dealers of other tobacco products (OTP), which includes vapor products, must get a license for each of the following locations (1) where a wholesaler makes OTP; (2) where a wholesale dealer or retail dealer receives or stores non-tax-paid product; and (3) from where a retail dealer that is a delivery seller or remote seller ships sales, if other than the location in (2). Dealers of OTP, except for vapor products, must file certain forms, some of which are related to MSA compliance, but dealers of vapor products file different forms. Since an OTP licensee may sell or possess any tobacco product except for cigarettes, DOR does not necessarily know which forms it should expect from which dealers based on their licensing status. By separating the licenses, DOR will know which reports should be filed by the licensees. The fees are the same as the existing OTP license fees: $10 for retailers and $25 for wholesalers. With this change, a dealer that sells both vapor and non-vapor OTP will have to get 2 licenses per location.	July 1, 2024, and applies to licenses issued on or after that date.
3.9	Aligns record retention requirements for persons required to file a report or return for alcoholic beverage taxes with the applicable statute of limitations period. Currently, the statute requires that a person who is required to keep records under this Article preserve them for three years from the due date of the return to which the records apply. However, the statute doesn't address the record retention period for taxpayers who either (1) file a return after the due date of the return; or (2) pay a tax years after the due date of the return and subsequently file for a refund. This section provides that records must be preserved for the applicable statute of limitations period, or if the transaction for which records must be kept is not required to be reported in a return, for three years from the date of the transaction, and clarifies that the Secretary, or their designee, has the authority to inspect these records at any reasonable time.	When law and applies to documents required to be kept for transactions occurring on or after that date.
3.10	Clarifies that a credit for motor fuel tax paid is afforded to all motor carriers, not just those that are required to file motor carrier tax returns. There are two types of motor carriers: interstate, which operate in more than one state, and intrastate, which operate solely in North Carolina. Intrastate motor carriers are exempted from filing a motor carrier tax	When law.

	return under G.S. 105-449.45(b)(2). However, intrastate motor carriers are still subject to the motor carrier tax if they fail to maintain proper records related to their motor fuel transactions. This section clarifies that a credit for motor fuel taxes paid is afforded to both interstate motor carriers and intrastate motor carriers.	
3.11	Clarifies that the tax owed by interstate motor carriers is due when a quarterly return is required to be filed under G.S. 105-449.45. Currently, the statute says that the tax is owed when a return is filed. However, this is not how the Department interprets and administers this statute. This section also clarifies that any motor carrier tax owed by an intrastate motor carrier is due when the tax becomes collectible.	When law.
3.12	Clarifies that a motor carrier tax return is due on the last day of the month following the calendar quarter to which the tax applies. The current statute states that motor carrier returns are due on the last day of April, July, October, and January, but does not tie the return to the previous quarter. This section also clarifies that an intrastate motor carrier must operate exclusively within North Carolina.	When law.
3.13	Clarifies that interstate motor carriers must keep records for the time required in any cooperative agreements entered into under G.S. 105-449.57. The cooperative agreements are entered into between states that participate in the International Fuel Tax Agreement (IFTA). This provision also provides that intrastate motor carriers, who are not a part of IFTA, must keep records for four years after the date of the transaction.	When law and applies to records for transactions occurring on or after that date.
3.14	Provides a grace period, until the end of February, for motor carriers to carry a copy of their current year motor carrier license in their motor vehicle and display the appropriate current year decals on the motor vehicle. A grace period is already afforded to interstate motor carriers under IFTA. However, no equivalent grace period is afforded to intrastate motor carriers. This provision provides that the grace period applies to both interstate and intrastate motor carriers.	When law.
3.15	Corrects a statutory reference omission. Last biennium, the provision allowing a person who purchases motor fuel for off-highway use to receive a refund of the excise tax paid on that motor fuel was moved from G.S. 105-449.107 to G.S. 105-449.106. However, the statutory references in G.S. 105-449.61(a) were not updated to reflect that change. This section corrects that.	When law.
3.16	Clarifies that a licensed supplier who is a position holder may take a credit for tax-paid motor fuel in the terminal system. When motor fuel is in a terminal, it must be non-tax-paid to prevent any double taxation. Therefore, if the tax has already been paid on the motor fuel when it is in a terminal, a credit must be provided to revert the motor fuel back to	When law.

	non-tax-paid status. This is the current practice of the Department and is consistent with the advice provided to taxpayers.	
3.17	Allows any person in a nonprofit to request a quarterly refund of motor fuel tax paid by the nonprofit. Currently, only the chief executive officer of a nonprofit may request a quarterly refund. However, this is not consistent with the authority provided to other entities allowed to request a refund of motor fuel tax paid.	When law.
3.18	Aligns record retention requirements for persons required to file motor fuel tax returns with the applicable statute of limitations period. Currently, the statute requires that a person who is required to keep records under this Article preserve them for three years from the due date of the return to which the records apply. However, the statute doesn't address the record retention period for taxpayers who either (1) file a return after the due date of the return; or (2) pay a tax years after the due date of the return and subsequently file for a refund. This section provides that records must be preserved for the applicable statute of limitations period and clarifies that the Secretary, or their designee, has the authority to inspect these records at any reasonable time.	When law and applies to documents required to be kept for transactions occurring on or after that date.
3.19	Aligns record retention requirements for persons required to be licensed under Article 36D (Alternative Fuel) with the applicable statute of limitations period. Currently, the statute requires that a person who is required to keep records under this Article preserve them for three years from the due date of the return to which the records apply. However, the statute doesn't address the record retention period for taxpayers who either (1) file a return after the due date of the return; or (2) pay a tax years after the due date of the return and subsequently file for a refund. This section provides that records must be preserved for the applicable statute of limitations period, or if the transaction for which records must be kept is not required to be reported in a return, for three years from the date of the transaction, and clarifies that the Secretary, or their designee, has the authority to inspect these records at any reasonable time.	When law and applies to documents required to be kept for transactions occurring on or after that date.
3.20	Aligns record retention requirements for persons required remit the inspection tax with the applicable statute of limitations period and provides that the Secretary, or their designee, has the authority to inspect these records at any reasonable time. This section further provides that an inspection tax return must be in the form prescribed by the Secretary.	When law and applies to documents required to be kept for transactions occurring on or after that date.

3.21	Provides that fuel grade ethanol or biodiesel fuel that is removed from the terminal transfer system prior to being blended is subject to taxation. Products, such as fuel grade ethanol and biodiesel, leaving the terminal transfer system without being blended are taxable at the federal level, but escape taxation at the State level. This section ensures that all motor fuel products that leave the terminal transfer system are taxable in North Carolina. This section also clarifies that a transfer of motor fuel within the terminal transfer system to a person not licensed as a supplier is only taxable if the transfer occurs at a terminal. Motor fuel is often transferred to multiple persons while in the terminal transfer system, however, liability should only be imposed when this occurs at a terminal. This is consistent with advice provided by the Department to taxpayers.	When law.
3.22	Provides that excise tax does not apply to transfers of fuel grade ethanol or biodiesel between terminals in North Carolina if the fuel grade ethanol or biodiesel is owned by the same licensed supplier.	When law and applies to transfers occurring on or after that date.
PART IV. PROPERTY TAX CHANGES		
4.1	Repeals an outdated statute designating real property lying within a transportation corridor on an official map filed under the Transportation Corridor Official Map Act as a special class of property subject to a reduced appraised value. In 2019, the General Assembly repealed the Map Act so this statute is no longer necessary.	When law.
PART V. TAX ADMINISTRATION AND COLLECTIONS CHANGES		
5.1	Clarifies that, in a garnishment situation, the bad check or bad electronic funds transfer (EFT) penalties apply to the garnishee to the extent the garnishee issues a bad check or bad EFT. Under current law, the statute refers to the "drawer" of a bad check or the "transferor" of a bad EFT being subject to the penalty, and it's ambiguous about which party should be assessed the penalty in a garnishment situation.	When law.
5.2	Allows the Department to accept a request for review on forms other than the NC-242, which is consistent with current Departmental practice. The Department accepts these forms as long as they contain a clear statement that the taxpayer is requesting review of a denied refund or a proposed assessment.	When law.
5.3(a)	Creates a ten-year statute of limitations on tax collections by the Department. The ten-year statute of limitations period would begin on the date the taxes become collectible by the Department and may be	When law.

	tolled under certain circumstances.[3] If the tax is not collected by the Department within the statute of limitations, the remaining liability is abated. Currently, there is no codified statute of limitations on taxes that become collectible by the Department unless a certificate of tax liability is docketed, wherein the Department would have ten years from the date it was docketed to collect the tax or else the liability would be abated. This section creates a ten-year statute of limitations from the date the taxes become collectible by the Department regardless of whether a certificate of tax liability has been docketed. The ten-year statute of limitations provided for in this section is similar to the federal statute of limitations on tax collections. Under federal law, generally the Internal Revenue Service has ten years from the date of assessment to collect a tax liability.[4] Once that period expires, the Internal Revenue Service may no longer pursue collection of the tax.	
5.3(b)	Currently, a certificate of tax liability is enforceable for a period of ten years from the date it is docketed. This section provides that the period a certificate of tax liability is enforceable may not extend beyond the ten-year statute of limitations under Section 5.3(a) and makes other conforming changes.	When law.

[3] The ten-year period would be tolled during the following periods:

1. While the taxpayer is absent from the State. The period may be tolled during the taxpayer's absence plus one year after the taxpayer returns.
2. Upon the death of the taxpayer. The period is tolled while the taxpayer's estate is administered plus one year after the estate is closed.
3. While an action is pending to set aside a conveyance made by the taxpayer as a fraudulent conveyance.
4. While an insolvency proceeding against the taxpayer is pending.
5. During the period of any statutory or judicial bar to the collection of the tax.
6. The period for which a taxpayer has waived the ten-year period.

[4] 26 U.S.C. § 6502