

2009 NC Department of Revenue Questions & Answers

Communications

1. We have heard recently that the department will offer e-services specifically for the practitioner community (similar to the e-services practitioners' use with the IRS site) whereby we can access client-specific information (with proper authority), order transcripts online, and propose installment agreements, etc. directly from the site on behalf of our clients. Please discuss the information available to us, how to access it, how to register, etc. There seems to be some confusion about whether this is available. It is not currently on the "e-services" part of the website.

The Department does not currently offer as an online service the ordering of transcripts or proposing installment agreements. However, we offer a variety of electronic services to taxpayers and taxpayer representatives such as:

- **Individual Income e-File :** Electronic filing of current year individual income tax returns through the Federal/State Individual Income Tax e-File Program.
- **Sales and Use Tax Online File and Pay:** Online file Form E-500, Sales and Use Tax return, and pay the tax by bank draft or credit/debit card.
- **E-Business Center:** Online file and/or pay a number of different business taxes, such as withholding tax and corporate estimated tax; store payment and business information for reuse; view history of online tax transactions; and conduct other business with the Department. Access is through the use of a North Carolina Identity Management Service (NCID) user ID and password.
- **E-Alerts:** Subscribe to receive emails from us about important tax information updates, such as notices about law changes.
- **Online Business Registration:** Electronically register for an account ID number for Income Tax Withholding, Sales and Use Tax, and Machinery, Equipment, and Manufacturing Fuel Tax, instead of submitting the Form NC-BR, Business Registration Application.

For a list of all of our electronic services, including the ones listed above, select the Electronic Services tab on the Department's homepage at www.dornrc.com.

2. What is your position on adding a "third party designation" to various NC tax forms, so we can discuss items with the DOR without having to have a POA form on file?

The Department would not oppose adding a "third party designation" to the individual income tax return (similar to that provided on the Federal Form 1040) to allow a taxpayer to designate an individual to discuss certain items on the return without a Power of Attorney on file.

3. You had previously told us that your policy regarding POAs is you will accept the 2848 if the taxpayer specifically indicates on the form that it can be applied to state tax matters. However, our experience has been that sometimes DOR agents will accept the 2848 if the D-400 is listed, but other agents tell us that will not work and we must have the GEN 58. Please clarify your official policy on this for us.

We prefer our Form Gen-58 be filed. However, federal form 2848 may be filed in lieu of Form Gen-58, provided the form includes all pertinent information requested on

Form Gen-58 and specifies that a taxpayer is authorizing the DOR to discuss State tax matters with the named representative(s).

4. Please tell us what we should do when representing a client under exam or audit when the DOR agent violates the directive of a valid POA on file, which allows us to be copied on time sensitive documents like Notices and Garnishments. The POA grants us the authority to represent the taxpayer before the DOR and to receive and inspect confidential tax information. If that is the case, the practitioner should not be the last to know when the client receives notices. There have been situations this year where we submitted a valid POA before filing a client's returns. Then after the returns were processed, the taxpayer would get notices of assessment, final notices, proposed notices, collection notices, etc., and we never got copied. If we had, we could have gotten involved sooner and reduced everyone's work load. We want to partner with the client and the department on these matters and work to mutually resolve situations. Please give us some guidance on how to address these situations when they occur.

Our policy is to always communicate with the power of attorney if our records indicate that there is a valid one on file. However, notices and certain correspondence automatically generated by our computer system are sent to the taxpayer and our current system does not have the capability to simultaneously send a copy to the power of attorney. We plan for our new system to have this capability.

5. Please confirm the department's authority of requiring the POA be sent in with original signatures. Some exam DOR agents have refused to work with us due to the POA not having original signatures. We cannot find in the general statute any such requirement.

The Department is charged with protecting taxpayer information under G.S. 105-259. As part of this responsibility, the Department must ensure the accuracy of POAs which the Department receives from people claiming to be taxpayer representatives. The Department therefore requires that a valid POA: (1) address the tax types and time periods for which the representative is authorized to communicate with the Department; (2) be signed and dated by both the taxpayer and its representative; and (3) include a social security number or other valid taxpayer identification number. Additionally, for its recordkeeping purposes, the Department prefers to receive original copies of POAs. However, in exigent circumstances, the Department will accept POAs delivered in other manners, such as via fax or PDF.

6. In light of the money in the state budget slated to improve/enhance/overhaul your computer system, what kinds of improvements in customer service should we expect to see? For example, will the new system have more transparency on the assessment for underpayment notices (where the notices would show a complete history and breakdown of the payments credited to the account, money withheld, estimated tax payments made, etc.)? Will it be easier to communicate with the DOR?

The Department's new tax system will enable expansion of online e-services, provide new customer relationship management tools to improve customer service and the ability to communicate with the DOR, and improve the quality of notices.

Enforcement, Audit, & Collection Matters

7. Please discuss your decision to target for audit individual returns that claimed more than 6 personal exemptions on the 2008 tax returns. What was the reasoning behind that, and please share with us the results of that.

The Department has identified noncompliance with respect to individual income tax returns claiming excessive exemptions and erroneous filing status. The Department has historically identified and audited taxpayers with respect to this type of noncompliance. The examination division requested taxpayers submit appropriate documentation to verify the filing status and number of exemptions claimed. This verification process was implemented in lieu of subjecting the taxpayer to an audit.

The Department identified 7,065 tax returns and realized a tax savings of over \$4.8 million dollars through this verification process.

8. Please share with us how we as the practitioner community can help the department speed up and facilitate the processing of amended returns. Also, what is your current policy on the timing of processing amended returns? Our understanding from previous meetings with you is that amended returns are processed as they come in and not after all current year returns are processed. Now we have been told that the policy is to wait for IRS approval of the amended returns before you will process them. Please explain why that policy is in place and help us clarify some questions – for example, how does the department know when the IRS has approved an amended return? Do they send some kind of communication to the department? Furthermore, how does this policy interface with the collection/enforcement division so as to have an equitable outcome? Is there a way to put collection efforts in a suspended status while you are waiting to get approval from the IRS? Otherwise, it would seem unfair to proceed with collections activities when an amended return would clearly show that the return currently on file (on which collections is based) is erroneous.

The practitioner community can facilitate the process by ensuring all documentation needed to substantiate any adjustments to the original return is attached to the amended return. If the change is also applicable to the Federal return, include a copy of the Federal 1040X.

Pursuant to G.S. 105-241.7, enacted as a result of Senate Bill 242, the Department must approve the refund, in whole or in part, deny the refund in its entirety, or request for additional information from the taxpayer within 6 months from the date the Department received the amended return. The examination division works diligently to process the amended returns in a timely manner. In some instances, where additional documentation is needed to process the amended return, the Department and taxpayer may enter into a mutually agreed upon time to process the amended return.

It is not the Department's policy to wait for IRS approval of the amended return before NCDOR processes the return. Forced collection activity may be placed in a hold status during the amended return review process, if adjustments indicated on the amended return clearly reflect an assessment is erroneous.

9. Please address the policy in place when a business taxpayer submits an NC-5 showing zero withholding liability. Frequently our experience has been that the department will send a bill for

\$43 plus penalty and interest. Then when challenged by the practitioner on behalf of the client, they will remove that. What is the reasoning for sending such a bill?

There is no policy in place for automatically assessing a business taxpayer who submits an NC-5 showing a zero balance liability. We will be glad to research the issue if specific examples are provided.

The Department is unaware of any assessment notices generated under this scenario. Please provide the Department some examples and we will advise of our findings.

10. Please tell us the department's efforts to help taxpayers in financial distress because of the recent economic downturn. The IRS has been told by Congress to be more lenient with taxpayers during these times (example: make it easier for taxpayers on installment agreements to modify downward their monthly payment obligation, etc.). Given the economy, does the department have any general policies in place for dealing with troubled taxpayers?

The Department recognizes that during good economic times and bad, some taxpayers face financial hardships. When times are bad, the number of taxpayers facing bad situations escalates. But the Department has methods to assist financially distressed taxpayers in returning to compliance. Taxpayers may request a payment plan from the Department to liquidate their debt over a period of time. Depending on the seriousness of their situation, they may also qualify for an offer-in-compromise. Additionally, it's important to note that North Carolina's wage garnishment is limited to 10% of gross income. The IRS takes all disposable income and many states have 100% wage garnishment provisions.

11. We have seen an increase in the frequency of notices sent out incorrectly. What have you seen? For example, there seem to be more notices sent out with inaccurate figures, notices sent out asking for missing returns when in fact those return were filed (certified mail), and notices for franchise fees not being paid with the return when in fact the check was sent (upon challenge, we proved the check was cashed and then the matter was resolved).

We are not aware of an increase in the frequency of notices being sent out incorrectly. If the members can provide specific examples, we will be glad to investigate.

12. What is the audit selection procedure, the criteria for being selected for audit? Please give us a breakdown of how taxpayers are selected for audit (random, non-filing, underreported income history, etc.). Do DOR agents and revenue officers have any input on which taxpayers get selected?

The Department is responsible for administering the tax laws and determining taxes due to the State in an impartial, uniform, and efficient manner. The Department utilizes various data sources and analytics to determine areas of non-compliance. Identified taxpayers that are potentially not in compliance will be subject to an examination of their books and records. Field Auditors may have input on audit selection if potential non-compliance has been identified. Supervisory review and approval is required of any Field Auditor selection of a potential audit candidate.

13. What is the department's policy on offers in compromise? Is it similar to the IRS' position, which seems to be OICs are no longer an effective means of settling collection matters (according to the National Taxpayer Advocate's report)? Do you still settle OICs based on the same basis as the IRS? Do you wait until the IRS completes the OIC process and makes a decision or do you operate independently?

North Carolina's offer-in-compromise program is governed by N.C. Gen. Stat. §105-237.1. There is no relationship between the State and Federal in determining whether a taxpayer qualifies for an offer-in-compromise. The Department is currently reviewing the offer process and is working on a series of changes. We believe the changes will make the process more transparent and will help taxpayers and practitioners determine an appropriate offer amount. The Department plans to roll-out the changes around the end of the year.

**Here is a link to our website for additional information about the offer program, governing statutes, and required forms:
http://www.dornnc.com/collect/offer_faq.html.**

14. What has been the department's experience with the new protest procedures effective 1/1/08? Also, please share with us the number of appeals, number of cases.

Individual Income Tax Requests for review	291
Individual Income Tax Petitions to OAH filed	11
Corp. Requests Tax Requests for Review	100
Corp. Tax OAH petitions filed	5
Sales and Use Tax Request for Revenue	130
Sales and Use Tax Petitions to OAH filed	5

15. Regarding collections, does the DOR have and utilize the "nominee lien" and "alter ego" lien procedures?

"Nominee Lien" and "alter ego lien" are IRS procedures and do not apply to state tax collection procedure.

NC law does contain a similar procedure. NC Gen. Stat. §105-239.1 provides that, "Property transferred for an inadequate consideration to a donee, heir, legatee, devisee, distribute, stockholder of a liquidated corporation, or any other person at a time when the transferor is insolvent or rendered insolvent by reason of the transfer is subject to a lien for any taxes owing by the transferor to the State of North Carolina at the time of the transfer, whether or not the amount of the taxes has been ascertained or assessed at the time of transfer."

NC Gen. Stat. §105-241 establishes this tax lien. Under this section, the lien of a tax attaches to all real and personal property of a taxpayer on the date a tax owed by the taxpayer becomes due. The lien continues until the tax and any interest, penalty, and cost associated with the tax are paid.

PROCEDURE

The Department may proceed to enforce a lien that arises under this section against property transferred by a taxpayer to another person or to hold that person liable for the tax due by sending the person a notice of proposed assessment in accordance with NC Gen. Stat. §105-241.9. If the Department finds that collection of the tax is in jeopardy, a jeopardy assessment and collection action may be initiated against the transferee as provided for in NC Gen. Stat. §105-241.23. Protections afforded by the respective assessment statutes are available to the transferees receiving them.

The Department has the burden of establishing that a person to whom property was transferred is liable. The period of limitations for assessment of any liability against a transferee or enforcing the lien against the transferred property expires one year after the expiration of the period of limitations for assessment against the transferor.

PROCEEDS

When property transferred by a taxpayer to another person is sold to satisfy the lien that arises under this section, the person is entitled to receive from the proceeds of the sale the amount of consideration, if any, the person paid for the property. The proceeds must be applied for this purpose before they are applied to satisfy the lien. Proper documentation and proof of purchase must be provided by the purchaser to the Department.

16. Please address the department's current positions with respect to the escheat laws? That is, if a taxpayer who has never filed wants to come into the system and start filing on a current basis (annually), can they get any assurances that DOR will not go back beyond a certain point or perhaps not go back at all? Who should we contact on behalf of a client to establish such an agreement?

A taxpayer may request to participate in the Department's Voluntary Disclosure Program for any tax schedule administered by the Department of Revenue. If the taxpayer meets the participation requirements, the Department will limit the look-back period to 4 years.

17. As a result of NC Gen. Stat. §105-241.22, the need for the proposed assessment has been eliminated. This has expedited assessments and gives the taxpayer less time to respond to the amount and possibly request a conference or hearing about the taxes. Given this change, entering into payment plans is more likely and critical than before. Given this reality, please address what appears to be less accommodation of the department in working with taxpayers to set up payment plans. What has changed in your policy with entering into payment plans this year? Likewise, can you please address the policy on assessing criminal charges on delinquent taxpayers and whether that has changed over the past year.

In accordance with the statute change, the Department has changed its process to eliminate the proposed assessment when taxpayers file a return showing a balance due but fail to pay the amount shown due with the return. The General Assembly determined that a right to protest was not necessary in these situations, since the taxpayer stated the amount due on the return, but elected not to pay it. The Department continues to issue proposed assessments for any liabilities it discovers, such as for an audit adjustment.

Payment in full is expected at the time a North Carolina State tax return is filed or a liability is discovered by the Department and assessed. Occasionally, taxpayers do not have the ability to immediately pay the tax in full. In limited circumstances, the Department will negotiate installment payment agreements based on financial need that allow taxpayers to repay tax debt over a period of time. NC Gen. Stat. §105-237(b) provides that the Secretary may enter into an installment agreement if it will facilitate collection of the tax.

In some situations, the Department establishes payment plans without any review of financial condition for short-term agreements involving small amounts of debt. For longer-term agreements, agreements involving large amounts of liability, or when a taxpayer with a history of non-compliance is the subject of the agreement, the Department requires financial statements and supporting documentation. A review of the taxpayer's financial condition is performed to validate financial need for the payment plan.

The primary goal of any collection action, including an installment payment agreement, is to bring the taxpayer into compliance. Occasionally, a taxpayer will establish a payment agreement for one filing period, fail to pay the tax due for an additional period(s), and then request that the Department build the additional period(s) into the payment agreement. This type of behavior does not promote compliance, is not fair to the vast majority of North Carolina taxpayers who pay their taxes in full and on time, and cannot be permitted by the Department.

The Department has information about payment plans on its website. For your convenience, here is a link: <http://www.dornnc.com/collect/installment.html>

Filing and Operational Procedures (and Misc.)

18. What is your policy regarding electronic filing of extensions – both present and future? Currently, our understanding is that taxpayers must file extensions (individual and corporate) via mail. Is the department planning to accept extensions electronically, as the IRS does, and if so, what is the time horizon for this to be implemented?

Currently, only the D-400 income tax return and the D-400TC tax credit schedule can be transmitted electronically through the Fed/State E-File Program. The Department is currently reviewing requirements for expanding the number of forms that can be filed through the program, but a date for implementation has not been determined. The Department's Online Filing and Payment System does allow an individual taxpayer to file an individual income tax extension and make any necessary payment by credit/debit card or bank draft.

19. We have seen a rash of errors regarding estimated tax payments for married taxpayers filing joint returns this past tax season, where the NC-40 is submitted with the payment, but the payment is posted to the spouse's SSN, rather than the primary taxpayer's SSN. Then an underpayment notice is mailed to the taxpayer. Please explain whether there is any kind of system in place where the department would review the NC-40s during processing for both SSNs.

A process is in place to identify and review prepayment discrepancies and potential underpayment notices when a payment exists in the separate or joint accounts

between the two entities of the joint entity. The payment(s) is then moved to the account for which the return was filed, typically eliminating the discrepancy and underpayment notice. As a result of your inquiry, we have learned we had some issues this filing season with employees following procedures and have revised the procedures to resolve the problem. You can help limit the number of items to be reviewed by ensuring your clients are making extension and estimated payments in the same filing status in which the return will be filed.

20. What is the department's goal and estimated time horizon for being able to have partnership and corporate income tax returns e-filed?

The Department plans to provide a system for e-filing corporate and partnership returns as soon as possible. However, the IRS is currently engaged in modernizing the existing Fed-State Joint e-file platform for personal returns to provide more efficient e-file processing. Consequently, the Department has been forced to shift its focus and resources to comply with the new IRS e-file platform requirements scheduled to be in place after January 2012, although no definite date has been set. Because of the time and effort required to comply with the new requirements, the Department does not expect to have a system for e-filing corporate and partnership returns in place until after that date.

21. What kind of turnover has the department experienced in the last year? How long does new agent training take? What are the educational and experience requirements for hiring new agents?

The Examination Division realizes "turnover" each year as a result of an employee's decision to retire and/or seek other employment opportunities. The duration of training for examination staff depends upon the education and experience level of the new employee. Please visit the Office of State Personnel website to view educational and experience requirements.

22. Please address the department's policy on the billings in excess of cost addback to the franchise tax calculation, in light of the attorney general's recent ruling. There still seems to be some confusion on this in the practitioner community.

For tax years prior to 2010, the Department requires the reserve for billings in excess of cost to be added back to the capital stock base. The Department's position is supported by an Attorney General's opinion.

23. Is there anything in the works to expand the number of "other state tax credits" allowable for e-filing. The current e-filing rule is you can't e-file a NC personal return if it has more than one state credit, and foreign tax credits are treated as another state. So if someone files in one other state and also has a foreign tax credit, they can't e-file their return.

There is no rule that prevents e-filing of an individual income tax return on which tax credits for tax paid to more than one state or country are allowable. However, some tax software packages may be limited to the point that they may not allow the

calculation of an out-of-state credit if multiple states are involved. If that is the case, a taxpayer may be prevented from e-filing the return.

The out-of-state tax credit computation on an e-filed return is determined in the same manner as the credit on a manually prepared return. If multiple states or countries are involved, taxpayers are instructed to compute the credit for each state or country separately and enter the total credit (limited to the tax liability) on line 7a of Form D-400TC. Line 7b should reflect the number of states for which credits are claimed, and lines 1 through 6 of the form should be blank. An e-filed return submitted in this manner should process without incident if there are no other errors.

24. Would the department be in favor of changing the non-resident withholding rules on partnership returns to eliminate non-resident withholding if the partner will not owe any tax to NC when eventually filing their return?

The requirement to pay on behalf of nonresident partners is statutorily mandated (N.C.G.S. 105-154(d)), and the DOR would not be in favor of changing the law.