

**NCACPA TAXATION COMMITTEE**  
**Subcommittee 2012 Questionnaire**

**A. Business Tax**

Could you please address the issue of the NC Add-back with regard to bonus depreciation? Is there any way to avoid the rule of adding back the federal 168k bonus depreciation when the taxpayer receives no current-year benefit on the federal return for the depreciation due to passive activity loss limitations? In these cases, the taxpayer receives no current year federal benefit, but he has to add this back for state purposes. We want to know if there is any "wiggle room" in cases like this. We have clients for whom this has caused very large NC adjustments – specifically, clients in new construction or improvement businesses.

**Response by Lennie Collins**

**No. There is no "wiggle room" with regard to the statutory adjustments required under N.C. Gen. Stat. §§105-130.5(a)(15b) and 105-134.6(c)(8b). It is the Department's position that the add-back of the applicable percentage of the additional first-year depreciation is statutorily required in the year in which the additional first-year depreciation is claimed. If a taxpayer calculates a loss from an activity because the expenses, including depreciation, exceed the income from the activity and the ability to deduct the loss is limited due to the passive loss rules, the taxpayer has still claimed the entire amount of additional first-year depreciation in arriving at the loss, even if the loss itself is carried forward to another year rather than being claimed in full in the current year. The taxpayer will never claim the additional first-year depreciation again for the assets acquired during the current year even though the tax benefit from the deduction may be realized in later years. The add-back is not measured by the amount of tax benefit received by the taxpayer, either in the year of deduction or during the lifetime of the asset.**

**B. Sales Tax**

1. This question relates to sales tax on the items such as solar panels, racking, and inverters that become parts of solar electrical generation systems. "Electric Companies" are allowed to pay the 1% privilege tax in lieu of the general sales tax on components of their power generation systems. Electric Companies are defined as businesses that produce power which is sold to end users. Utilities such as Duke regularly use the exemption even though power is often sold on the wholesale market as opposed to directly to end users. Solar generation systems are often privately owned and are prohibited from selling to end users. Instead they are required to sell the power generated to a public utility such as Duke. Our question is whether the private solar producers qualify as "Electric Companies" and can pay the privilege tax in lieu of the regular sales tax.

## **Response by Eric Wayne**

**A presentation titled Taxation of Solar Electricity Equipment was conducted by Y. Canaan Huie, General Counsel, during the March 7, 2012 of the Revenue Laws Study Committee. A copy of the presentation is available under the March 7, 2012 meeting materials on the Revenue Laws Study Committee website. The taxation of the solar electricity equipment depends on a number of factors. The Department is aware that there are a number of different scenarios that result in the production of solar electricity.**

**Qualifying purchases of solar electricity generating equipment by private companies to produce solar power where 100% of the produced power is sold to a utility or power company are subject to the 1% Certain Machinery privilege tax with an \$80.00 maximum tax per article. Such qualifying purchases that are subject to the 1% excise tax are exempt from sales and use taxes.**

2. Continuing with the above question, please explain what happens when the power is "net metered." A prime example of net metering occurs when a solar field is installed on the roof of a building. The building uses the power from the solar installation and any left over power is sold to the public utility. During times (night) when the solar equipment is not generating power, the building will purchase power from the utility. Under this scenario, a portion of the power is used by the owner and a portion is sold to the utility. How is sales tax computed/assessed in these situations?

## **Response by Eric Wayne**

**Persons that purchase solar generating electricity equipment used in conjunction with "net meter" agreements with utilities or power companies are presumed not to be engaged in the business of producing electric power to be distributed to consumers and purchases and such purchases are subject to the general State and local sales and use taxes.**

3. Could the department please offer clarification on what an enterprise server operating system is -- specifically as it pertains to the exemption from sales/use tax for computer software that is designed to run on an "enterprise server operating system?" We are unclear exactly how the department defines an "Enterprise Server Operating System" and would like to get clarification from the department on its meaning.

## **Response by Eric Wayne**

**The legislation enacted by the 2009 General Assembly did not define the phrase "enterprise server operating system." Discussions were held with General Assembly staff and various business representatives in an attempt to further identify and determine the legislative intent of the software exemption pursuant to G.S. 105-164.13(43a) for computer**

software designed to run on an enterprise server operating system. Additionally, it is important to note that the language of the exemption was enacted using the term “designed.”

The General Assembly Finance Team Legal Staff indicated in the 2009 Finance Law Changes publication that as a result of the elimination of the exemption for prewritten computer software when delivered electronically, the General Assembly chose to carve out a “business-to-business” exception for enterprise software, which was referred to in the publication as software used by large businesses to run office operations, such as billing.

In February 2010, the Department issued Important Notice: Computer Software. The Department advised in the notice that “[t]he exemption includes a purchase or license of computer software for high-volume, simultaneous use on multiple computers, that is housed or maintained on an enterprise server or end users’ computers. The exemption includes software designed to run a computer system, an operating program, or application software. The delivery method of the computer software is irrelevant.”

### **C. Tax Credits**

1. It seems that there is some confusion regarding the new \$50,000 small business tax credit. The statute says that this credit is available “per taxpayer.” Some of our members have had conversations with the Department concerning this credit specifically as it pertains to a husband-and-wife owned business. The Department has told us that if the small business is owned by a husband and wife team that there is only one \$50,000 credit they are entitled to. This seems to conflict with the language of the actual statute. Could the Department please comment on this and tell us their rationale for taking this position?

#### **Response by Lennie Collins**

This is not a new tax credit. Rather, for tax years beginning on or after January 1, 2012, there is a new deduction available on the individual income tax return as explained in Directive PD-12-2. Although the bill initially restricted the new deduction to income from a small business, the size of the business is not a factor in determining whether the taxpayer is eligible for the new deduction in the language that became law.

The new deduction of up to \$50,000 may be claimed against a taxpayer’s net business income included in federal adjusted gross income (AGI) that is not considered passive under the Internal Revenue Code. In the case of a married couple filing a joint return where both spouses report a net business income, the maximum dollar amount applies separately to each

spouse's net business income included in AGI, not to exceed \$100,000 (maximum \$50,000 for each spouse).

The last question and answer in Directive PD-12-2 speaks directly to the question that you have posed. In that example, Taxpayers are a married couple filing jointly. Mr. Taxpayer owns 60% of a single pass-through entity and Mrs. Taxpayer owns the other 40%. Mr. Taxpayer reports \$60,000 of nonpassive income from the pass-through entity. Mrs. Taxpayer reports wages of \$20,000 and nonpassive income of \$40,000 from the pass-through entity on federal Schedule E. What deduction is available to Taxpayers? In this example Taxpayers are entitled to claim a net business income deduction of \$90,000 (\$50,000 for the husband and \$40,000 for the wife).

The information provided that the deduction is limited to \$50,000 in the case of a small business owned by a husband and wife team, is incorrect.

2. How does a not for profit organization filing Form 990 claim a tax credit for SUTA paid on employee wages?

#### **Response by Lennie Collins**

G.S. 105-129.16J allows a refundable tax credit equal to 25% of the contributions a small business makes to the State Unemployment Insurance Fund. The tax credit is available only for tax years 2010 and 2011.

A tax exempt organization may claim the tax credit only if it becomes subject to the income tax provided in G.S. 105-130.3 based on its unrelated business taxable income. Otherwise, the organization may not claim the tax credit because the organization is not subject to the income tax under G.S. 105-103.3. If available, the tax credit for a tax exempt organization is claimed on the Corporation Tax Return, CD405.

#### **D. Enforcement**

Please describe the types of penalties that the Department will consider for abatement and the limit. For example, a practitioner was informed by the Department that either the late filing or the late payment penalty was eligible for abatement, but not both penalties, pertaining to a late filed payroll return. What does the Department base this one and what is the rule on how many and what types of penalties can be abated?

#### **Response by Lennie Collins – Charlie Helms**

The information received by the practitioner is not correct. With regard to a late filed payroll return, only failure to file [GS 105-236.3] can be waived or abated. The failure to pay penalty on trust taxes withheld or

collected and not remitted such as sales and withholding (payroll taxes) cannot be waived or abated pursuant to the Department's penalty policy. In addition, penalties assessed for taxes that are not reported at regularly recurring intervals, such as the estate tax, gift tax and the unauthorized substances tax, cannot be waived or abated under the good compliance record reason in the general waiver criteria because these taxes lack the compliance history that is the basis of the good compliance record reason.

The North Carolina General Statutes require the North Carolina Department of Revenue to impose certain civil penalties on taxpayers who do not comply with the tax laws and give the Secretary of Revenue the authority to waive or reduce all of these penalties. [NC. Gen. Stat. 105-237] Two categories of criteria apply to the waiver of penalties: general waiver criteria which consists of three automatic reasons to waive a penalty and one conditional reason of good compliance record. The general waiver criteria apply to core penalties with exceptions mentioned above, and the special circumstances waiver applies in limited circumstances to all penalties with exceptions.

#### General Waiver Criteria

The general waiver criteria apply to the following core civil penalties for taxes reported to the Department of Revenue at regularly occurring intervals:

failure to file [GS 105-236.3];  
failure to pay [GS 105-236.4];  
the 10% negligence penalty [GS 105-236.5(a)];  
the 25% negligence penalty for individual income tax [GS 105-236.5(b)];  
and  
the 25% negligence penalty for taxes other than individual income tax [GS 105-236.5(c)].

Automatic waivers — General waivers are automatically granted as a result of:

the death of the taxpayer, the taxpayer's immediate family member, or the taxpayer's tax preparer;  
the serious, sudden illness of the taxpayer, the taxpayer's immediate family member, or the taxpayer's tax preparer; or  
a natural disaster, such as a tornado or hurricane, or an accident, such as a fire, that destroyed property, records or both.

Automatic waivers are granted for a three-month period from the time of the triggering event. If a natural disaster is addressed in a memo from the

Secretary of Revenue or the Governor, the automatic waiver period is the one set in the memo.

Good compliance record waivers — Good compliance record is the one conditional reason within the category of general waiver criteria. It is a conditional reason because the taxpayer must meet six conditions to qualify for a waiver under this reason. One of these conditions involves a "look-back" period.

The "look-back" period is a three-year period that consists of the taxpayer's most recent compliance history. It ends on the date a request for penalty waiver is being considered by the Department and it starts three years before it ends. In order to qualify for a general waiver or reduction of penalties for good compliance record, six conditions must be met:

the taxpayer must have filed all tax returns and tax reports due;  
the taxpayer must have paid any tax and interest due for the period for which the penalty waiver is requested as well as any amount shown due on a final bill received for a tax period that is different from the tax period for which the waiver is requested;

the taxpayer has received no 100% penalty waiver for that tax type based on good compliance record during the three-year look-back period;  
the error or practice that gave rise to the penalty is not the same as or similar to one found in a prior audit of the taxpayer;  
penalties are not assessed as the result of a taxpayer engaging in tax strategies by which income that would otherwise be taxable in North Carolina is shifted out-of-state or in other tax shelter activities that reduce or eliminate North Carolina state taxes; and  
the taxpayer has not been notified in writing that the taxpayer failed to provide all requested documentation and that the file is being so noted.

If married taxpayers file jointly, both spouses must meet all the conditions for a good-compliance-record waiver. If a taxpayer is individually liable for one tax and jointly liable for another, the taxpayer's compliance record for both types of taxes will be examined.

Taxpayers that meet all of the good-compliance-record conditions are eligible for waiver of the penalty in its entirety.

All penalties that are subject to the general waiver criteria and are assessed for the same filing period are treated as one for purposes of application of the good compliance record reason.

## Special Circumstance Waivers

Special-circumstance waivers are granted on penalties that are imposed for taxes that are not reported to the Department at regularly recurring intervals, such as the penalty for misuse of an exemption certificate. In limited circumstances, the category of special circumstances can also apply to the same types of penalties as general waivers. Special-circumstance waivers may be granted for all reasons except death, illness, accident, or natural disaster. Special-circumstance waivers are granted at the discretion of the Department and are the exception rather than the rule.

## E. Communications With the Department of Revenue

Would it help you if we were to work on legislating change with the handling of the annual report fees, so that the NC Secretary of State could accept the annual report fees and thereby remove the Department from the role of “facilitator” of this fee?

### Response by Tom Dixon

Yes, we would welcome this change. The collection point for the annual report fee has changed several times over a number of legislative sessions. The \$25 fee can currently be paid to the Department or at a reduced rate of \$18 if paid online to the Secretary of State.

## F. Operations

We hear questions from our members regarding the timing of the Department’s ability to accept corporate returns electronically. Can you provide us with insights that we can pass along to our members?

### Response by Jerry Coble

I am pleased to report that the Department implemented the MEF 1040 platform for individual income tax returns August 2012 which provided us much of the infrastructure needed for other MEF products. I reported last year that we wanted to expand the electronic filing platform to include the corporate return, but would need additional funding from the General Assembly. We have received an appropriation of 6 million to implement electronic filing for many more tax schedules. More than likely we will prioritize based on volume and other factors and hope to evaluate new functionality as well, such as: extensions, estimated, partnership and fiduciary which are also a part of the MEF platform.

## **G. Miscellaneous**

We continue to hear reports the 2013 session of the NC General Assembly will include discussions concerning tax reform and/or modernization. Can you share with us anything you have heard or been asked to comment on regarding components of the proposed legislation?

### **Response by Tom Dixon**

**The chatter concerning potential modernization of North Carolina's tax system has been fairly constant during this election cycle. We routinely work with the General Assembly on tax issues and have every expectation that we will be an active partner should they pursue a rewrite of the tax code.**