NCACPA TAXATION COMMITTEE

NC Department of Revenue Subcommittee 2013 Questionnaire

A. Sales Tax

Now that sales tax must be collected on service contracts for personal property, what is the treatment of bundled services on these items? For instance, where an HVAC contractor issues a single invoice that covers the purchase price of a new unit, installation, and a 3-year maintenance contract.

Response by Eric Wayne

SD-13-5 issued December 23, 2013 by the Department provides, in part, "The sales and use tax does not apply to a contract where a person agrees to maintain, service, or repair real property or an item of tangible personal property permanently attached to real property, provided such contract is sold to a purchaser after an item of tangible personal property is permanently attached to real property." If the 3-year contract is not in effect until after the new unit is installed by the HVAC contractor, such contract does not constitute a "service contract" to maintain or repair tangible personal property and the HVAC contractor will continue to owe sales and use tax on the purchase price of items used as part of the maintenance contract for the HVAC unit.

Also, for existing service contracts, must sales tax be collected beginning 1/1/14 or is it only for contracts that are renewed after that date?

A billing period for a "service contract" billed on a monthly or other periodic basis that begins on or after January 1, 2014, is subject to sales and use tax provided the contract is not for an item statutory exempt from sales and use tax in N.C. Gen. Stat. § 105-164.13 and no matter that the contract was executed prior to January 1, 2014.

B. Enforcement

1. What actions does the Department plan to take to discover and prosecute individuals responsible for identity theft to the extent it applies to fraudulent returns?

Response by Joe Whittington

The Department of Revenue's Criminal Investigations Section was recently given jurisdictional authority, by the General Assembly for identity theft as

it relates to State tax matters. N.C.G.S. 14-113.20, allows for the investigation and prosecution of these type crimes going forward. This new identity theft legislation, along with the current "Fraudulent Preparer Statute" (Aid and Assist in the Preparation of Fraudulent Returns N.C.G.S. 105-236(a)(9a), will enhance the ability of the Department of Revenue to pursue and prosecute these type crimes.

Article 19C.

§ 14-113.20. Identity Theft

(a) A person who knowingly obtains, possesses, or uses identifying information of another person, living or dead, with the intent to fraudulently represent that the person is the other person for the purposes of making financial or credit transactions in the other person's name, to obtain anything of value, benefit, or advantage, or for the purpose of avoiding legal consequences is guilty of a felony punishable as provided in G.S. 14-113.22(a).

(b) The term "identifying information" as used in this Article includes the following:

(1) Social security or employer taxpayer identification numbers.

(2) Drivers license, State identification card, or passport numbers.

(3) Checking account numbers.

(4) Savings account numbers.

(5) Credit card numbers.

(6) Debit card numbers.

(7) Personal Identification (PIN) Code as defined in G.S. 14-113.8(6).

(8) Electronic identification numbers, electronic mail names or addresses, Internet account numbers, or Internet identification names.

(9) Digital signatures.

(10) Any other numbers or information that can be used to access a person's financial resources.

(11) Biometric data.

(12) Fingerprints.

(13) Passwords.

(14) Parent's legal surname prior to marriage.

(c) It shall not be a violation under this Article for a person to do any of the following:

(1) Lawfully obtain credit information in the course of a bona fide consumer or commercial transaction.

(2) Lawfully exercise, in good faith, a security interest or a right of offset by a creditor or financial institution.

(3) Lawfully comply, in good faith, with any warrant, court order, levy, garnishment, attachment, or other judicial or administrative order, decree, or directive, when any party is required to do so. (1999-449, s. 1; 2000-140, s. 37; 2002-175, s. 4; 2005-414, s. 6.)

2. What is the Department's current strategy for processing appeals on a timely basis?

Response by Tom Dixon

Tax Administration maintains an appeals log that tracks requests for review from receipt to final resolution. DOR has made tremendous progress in reducing the backlog of appeals cases over the past year. Reaching a high of 1,624 cases in March 2012, the backlog has been steadily lowered to our current level of 506 cases (as of December 2013). The primary driver in that reduction was a shift to allow the Taxpayer Assistance Division to handle many of the personal tax requests which did not require action by Tax Administration personnel. The Sales Tax Division and Corporate Section of the Income Tax Division have also seen significant reductions in their inventory of cases. These numbers should be further reduced since we were able to add several positions to each of these divisions during the last session of the General Assembly.

3. We have noticed that requests submitted for voluntary combinations take a lengthy time to process. Can you please comment on this: Is it a resources or decision-making issue?

   Response by Lennie Collins

   The request for a Redetermination Private Letter ruling deals with very complex issues. Obtaining and evaluating information in order to determine if a corporation's State net income is not accurately reported on a single entity return because of intercompany transactions is a time intensive process and requires extensive analysis of information. The Income Tax Division has limited resources to dedicate to the process.

4. During the "Dark" period, will enforcement efforts be suspended in any way?

   Response by Tom Dixon

   The "Dark" period referenced the time that the Department would be unable to process payments and returns during the conversion from ITAS to TIMS. DOR had estimates that this transition could take from four to eight weeks depending on the success of the rollout. Since the final phases of TIMS will not be implemented, there will not be a "Dark" period for the foreseeable future.

5. Please comment on the Department's IRS-feed when the IRS resolves an audit matter as a "no change." Does the Department not cross-reference that? Here is a situation from one of our practitioners:

   The NCDOR should not assess on IRS notices that have already been resolved with no change. Is it possible this is due to a lack of sharing between taxing authorities? We have noticed this on much more than one occurrence: IRS sent a notice of proposed changes. We responded, the IRS agreed that no change was due, and issued a notice showing -0- payment due and no further action necessary. Two years later, the client received a notice from the NCDOR, assessing tax based on the IRS notice of two years ago.

   Response by Alan Woodard

   The Department does receive federal taxpayer information through our data exchange program with the IRS. Based on the information in question 5, it appears you are describing a CP2000 adjustment made by the IRS.
   The NCDOR receives six CP2000 extracts from the IRS annually which results in approximately 55,000 Notice of Proposed Assessments being

issued by the Department. However, the IRS sends the CP2000 information to the Department two years after the close of the tax year of the adjusted return. The examination division processes this information within two weeks of receiving the data from the IRS. Currently, the IRS does not have a process in place to provide the Department with any adjustments to accounts after the IRS has issued a notice of additional tax due. According the IRS Governmental Liaison, if taxpayers respond to the initial inquiry from the IRS, and resolve the issue prior to a Notice of additional tax due, the taxpayer data will not be transmitted to the Department. If you have specific Notices, please send them to me, and I will research and provide you with an update.

6. Please comment on the reason behind the Department placing telephone calls to our clients in advance of an audit letter. Is it a "courtesy" or does it perhaps stem from a local agent calling to schedule the audit meeting? Here is an example from one of our practitioners:

   A client received a phone call from the NCDOR regarding being selected for a "routine" audit. An official letter is to follow, the agent told the client. This seems to be protocol, as many clients have indicated the same. Typically little if anything is requested, just a heads up, but sometimes there are questions, which clients are unsure how to answer or if they should answer without first talking to us. This initial call seems to be a routing step, possibly viewed by them as a courtesy. But to some of our clients, it is unsettling to get a call like this, particularly in light of all the scams that are ongoing. We would like to recommend that phone calls like this come only *after* letters have been mailed, preferably a few days in-between.

   Response by Alan Woodard

   It is the examination division's policy and procedure to make first contact with a taxpayer selected for audit by a field auditor via telephone to ensure: (1) the auditor communicates directly with the designated person assigned to handle state tax audits; (2) ensure the audit confirmation letter is mailed to the proper individual at the proper address summarizing the content of the telephone conversation with respect to audit appointment dates and initial documentation required; (3) ensure taxpayer selects an audit appointment or pre-audit conference date compatible with their schedule; (4) provides a high level explanation of the audit process and scope, including potential computer assisted audit methods; (5) allows the auditor to answer any questions the taxpayer may have about the audit process and/or scope; (6) allows the taxpayer to obtain upfront information to aid in the taxpayer's determination of the number of days to block out for hosting on-site field auditors, or defer auditor to contact their tax representative.

DOR has found contacting taxpayers by telephone first to explain the audit process and scope has been informative and helpful to the taxpayer. The field auditor will always, upon request by the taxpayer, allow them to contact their representative before moving forward with any telephone conversation. If the taxpayer does in fact, request the auditor to discuss all tax matters with their designated representative, the field auditor is able to secure the contact information and request the taxpayer provide the field auditor with a properly executed Power of Attorney. The field auditor will, in turn, provide the taxpayer with a Taxpayers' Bill of Rights.

C. Communications With the Department of Revenue

Can you please comment on the implementation of the new telephone system? What progress is being made on this and does the Department have any procedures in place to enhance customer service in the call center? Additionally, when practitioners call in on the practitioner hotline, what advice can you give us to ensure we always reach a "Level 3" representative? Is our best course of action if we need Level 3 to simply call the practitioner line?

Response by Jerry Coble

In an effort to enhance and strengthen our ability to provide efficient and timely customer service, DOR has fully transitioned to a VOIP phone system. The system's skill based routing allows taxpayers to reach the employee who is specialized in a particular skill/subject based on the taxpayer's menu selection, which leads to quicker call resolution. The system further allows the Department to better manage its phone coverage resources by assigning employees to cover phone queues based on the business need or call projections. Currently, all taxpayers are directed to call the department's main toll free line.

The Department also provides the Tax Practitioner line which is staffed by Level 3 Taxpayer Assistance (TPA) employees. This group can assist with more complex tax application issues and we encourage practitioners to continue to use this line for assistance. We only ask that you do not share this number with the general public to help ensure other practitioners will have an opportunity to consult with our most knowledgeable employees. The number is (919) 754-2500.

D. Operations

1. In general, has the change in personnel over the last few years impacted the institutional knowledge at the Department – and if so, is there any initiative in place to deal with this loss?

   Response by Tom Dixon

   "Brain Drain" through the loss of key long term personnel is an issue with every organization, and DOR is certainly no different. To his credit, Secretary Gray has established an initiative to address succession planning within the agency by identifying future leaders and providing opportunities to grow into senior and executive leadership roles. One component of this plan is to periodically move personnel to other divisions within the agency, giving them a more comprehensive understanding of operations outside their particular organizational silo.

2. There is a great deal of confusion among practitioners regarding whether cases are being worked through Raleigh and the centralized toll-free line or at the local offices. Please comment on whether the following is an isolated situation or should we expect to see this trend?

   A "seasoned" practitioner told us that when he first went into practice in 1990, he dealt with his local revenue officer on most issues – developing a rapport with them where they would process multiple issues and notices all on the same local phone call or meeting. Thus, we would always know not to waste their time and they knew we would be efficient. A few years ago, he reports, he was instructed by his local (Greensboro) office that all notices had to from then onward be worked through the toll-free number in Raleigh. He was told that these changes to centralize would make things more efficient. Recently, though, he was told to again start working directly with the local offices. There seems to be some degree on confusion about which office will control a case. Please explain the current environment and procedures. What can be done to improve efficiency when dealing (through a POA) with the Department.

   Response by Jerry Coble

   Generally, the first contact to the Department should be via the toll-free number that appears on a taxpayer notice. Any employee who answers this queue should assist the taxpayer or their representative with the issue. If the issue is more complex than the employee can resolve, he/she will transfer the call to another level to help resolve the matter. The Department is working on increasing the skill-set of our agents to reduce the number of transfers and to improve customer service by offering "one and done" assistance through our toll-free lines. If the issue is complex or has

become a Collections issue, it may require interaction with a local Service Center.

As a point of reference, if a practitioner contacts the Department via written correspondence, it will be forwarded and resolved by the most appropriate level of employee in the Taxpayer Assistance Division. The TPA employee will either respond by telephone or written correspondence. Additionally, a direct telephone number for the TPA representative will be provided to the taxpayer/representative to facilitate a timely response.

Service provided through the telephone is much more cost effective than a face to face interaction. Consequently, this approach allows DOR to receive and resolve more taxpayer inquiries. While we would prefer to provide face to face interaction with all taxpayers, financially this is unfeasible for the Department. I would ask that you try the practitioner line for all non-collection activities.

Looking towards the future, the IRS is currently in the test phase of implementing webcam support for taxpayers. This approach would provide increased face-to-face service, though the representative may not actually be on site for the consultation.

3. Please comment on the Department's position on protective claims. We have encountered an issue with this pertaining to a 2008 issue as follows:

   A CPA had a client audited by another state. The client paid the taxes they owed to NC on the income, but as a result of the other state's audit, their allocation and apportionment was challenged. When they received the audit notice from the other state, the client filed a protective claim for refund, which is still provided for on the Department's website – that is what NC tells us to do. The client didn't receive their refund check because the state told them that there is some case that would affect people who filed protective refund claims. We are not aware of any cases like this. Has a change taken place in the Department's position on protective refund claims?

   Response by Eric Wayne

   The protective refund claim policy is repealed effective January 1, 2014. N.C. Gen. Stat. § 105-241.6(b)(5), effective January 1, 2014, provides an exception to the general statute of limitations for obtaining a refund of an overpayment due to a contingent event. Additionally, information regarding contingent events will be added to the website in the near future.

E. Miscellaneous: $50,000 deduction

Are partnership Guaranteed Payments included within the definition of net earnings from self-employment for purposes of this deduction? Is it just the line 1 of K-1 or also line 4 (guaranteed payments)? Here is an example specifically:

A single taxpayer is a member of a non-passive operating partnership. The taxpayer in question has no other income for 2012. His K-1 has only 3 items reported: a) Line 1 - $9,000; b) Line 4 - $70,000; c) Line 14- $79,000. What is the exact amount of the NC business deduction in this situation?

Response by Lennie Collins

The IRS provides instruction that for transactions between a partner and partnership, with regard to guaranteed payments from the partnership, those payments are reported as non-passive income on federal Schedule E. Income from Schedule E is considered in determining the net business deduction. The single taxpayer in the example is permitted a $50,000 deduction.