

**NCACPA TAXATION COMMITTEE**  
**NC Department of Revenue Subcommittee 2014 Questionnaire**

NCACPA's Taxation Committee is grateful to once again be given this opportunity to submit questions to the Department of Revenue from our practitioners. This is a most invaluable benefit and we continue to treasure the interchange between our two groups. Thank you!

Below you will find this year's questions.

Please do not hesitate to contact me if you have any questions about this document.

**A. Taxes**

1. Will the Department consider offering direct deposit of refunds on returns that are timely paper-filed and not e-filed, similar to the IRS's policy on refunds at the federal level?

*At this time, we are not looking to add this to the paper-filing process.*

2. What are your internal fees for electronic filing that are charged to the taxpayer? We understand that some software vendors have certain fees, but we are being asked to break down the fees that are from the Department verses our vendors.

*Currently we charge \$2.00/\$100 for credit card payments. There is no fee associated with bank drafts. The State Common Payment Service is being phased out, but the department's policy for passing along fees for credit card processing will likely remain in place.*

*There are no fees from NCDOR being charged directly to the taxpayer when electronic filing.*

3. Please clarify the Department's position on multi-state, multi-period performance-based compensation (not deferred comp) – where the compensation is earned in one state (Virginia, for example) but not paid to the taxpayer until the new year (when the taxpayer then resides in NC). Which state must perform the withholding and remittance of payroll taxes and which state will expect that income to be reported as earned income in that state for income tax purposes?

North Carolina General Statute 105-153.2 imposes an income tax on all income received by a resident from whatever source. In the scenario you outlined, the income would be taxable to North Carolina in the year it was received because the taxpayer was a resident. The state where the income was earned may also deem the income to be taxable for their purposes. If that occurs, North Carolina would allow a tax credit based on the tax paid to the other state.

As a resident of this State, an employee is subject to North Carolina income tax withholding on all wages received; however, in an effort to prevent double withholding and in anticipation of a tax credit, North Carolina will not require withholding if the state in which the services are performed requires that income tax be withheld.

4. Please comment on the Department's policy regarding sales tax imposition on leases in situations where a lease (same tenant) changes from a long-term to a month-to-month lease. We had a practitioner contact recently the Department on this and was told that in this situation it amounts to a verbal continuation of the long-term lease and therefore the lease would remain sales-tax exempt. Is that still the Department's official policy and what is the reason behind this thought process?

If the provisions of the original lease at the time of execution provide that the tenant/lessor can change the specific lease from a long-term to a month-to-month lease, provided such receipts derived from the long-term lease were exempt from sales and use tax, lease receipts would continue to be exempt from sales and use tax during the month-to-month period. Provided however, if the tenant and lessor enter into a new lease arrangement for a month-to-month basis, the new lease arrangement is a separate transaction subject to or exempt from tax as applicable.

5. Please address the Department's position on taxation of professional athletes who are non-residents of NC but play for a team based in NC, as well as those playing for teams based outside of NC but with scheduled games in NC. Likewise, what about other non-residents performing services in NC associated with these teams (game officials, announcers, TV crews, employees in general, etc.)

North Carolina uses the "duty day method", as prescribed by 17 NCAC 06B.3905 of the North Carolina Administrative Code, to determine the amount of income received by a nonresident member of a professional athletic team that is taxable to North Carolina. The duty day method is described in detail in the Individual Income Tax Rules and Bulletins.

The term “member of a professional athletic team” includes active players, players on the disabled list, and any other persons required to travel and who do travel with and perform services on behalf of a professional athletic team on a regular basis. This includes, but is not limited to, coaches, managers, and trainers.

The other nonresident individuals performing services associated with the games that you describe would be taxed in the same manner as any other nonresident individual. North Carolina General Statute 105-153.2 imposes a tax on all nonresidents who derive income from North Carolina sources.

Nonresident individuals who are employees of an employer other than members of a professional athletic team (for example, a referee) are subject to North Carolina income tax on any part of the wages paid for performing a service in North Carolina. Nonresident individuals who are not considered employees are subject to income tax on the total income received under the contract for performing the service in North Carolina.

## **B. Enforcement**

1. Please explain any new audit initiatives the Department is considering this year – and additionally, the reasoning behind such.

Included within response for Question #2.

2. Similarly, please comment on the Department’s audit program where the audits originate not because of a federal audit – so, NC-originated audit initiatives the Department plans to roll out. Again, please also offer the reasoning behind the program.

The examination division’s primary objective is to identify non-compliance; audit the books and records of taxpayers not in compliance; and recover lost revenue owed to the State. The Examination Division implements audit strategies to level the playing field for North Carolina citizens and businesses. Each year, examination division leadership develops and implements the audit strategy for the upcoming fiscal year based on identified areas of non-compliance and trends in non-compliance. The audit strategy is multi-pronged and encompasses multiple specialized initiatives. The examination division continually has over 30 initiatives in progress within the audit strategy. Each initiative is analyzed throughout the fiscal year to determine continued viability, efficiency, effect on compliance and meeting requirements to realize exam and Department of Revenue objectives. Although we only have two initiatives that involve Federal audits, we do have many that involve the exchange of Federal

information. Below are a few of our initiatives that do not involve Federal information at all and are based on identified non-compliance issues.

1. ITIN initiative – This initiative is based on individual income tax returns that are filed with the Department with erroneous filing status and excessive exemptions claimed.
  2. 4% ITIN initiative – This initiative is based on non-compliance with ITIN holders receiving cash payments for non-employee compensation and resulting in non-filed income tax returns
  3. Schedule C – This initiative is based on identified non-compliance with respect to filers that inflate expenses and under-report income
  4. Schedule A – This initiative is based on identified non-compliance with respect to filers that inflate deductions claimed on schedule A
  5. 1099 NRS – This initiative is based on identified non-compliance with respect to non-resident individuals selling real property within North Carolina and failing to report income in North Carolina by filing an individual income tax return
  6. CIBA – We continue to see non-compliance within the cash intensive businesses. An initiative across many business classifications identifies taxpayer's that under-report income, overstate expenses, and have compliance problems within other tax schedules. Generally taxpayers have no records and an indirect audit methodology must be implemented.
  7. MSA – The examination division supports the Master Settlement Agreement by performing comprehensive audits involving Tobacco manufacturers, distributors, and retail licensees.
  8. The Department continues our sales/use tax initiatives involving purchase of ATV's, boats, and other products identified by U.S. customs.
3. What patterns of errors or underreporting of income is the Department seeing that we can perhaps help correct through taxpayer education?

The Agency continues to see taxpayers that operate in cash fail to report all of their gross income. Additionally, we see taxpayers within the cash intensive business industry fail to keep records and inflate expenses reported on their tax returns.

Other general problems include failing to claim the proper filing status, not claiming the proper exemptions on Form NC-4 resulting in additional tax liability or non-filer status, misclassified workers, and failing to accrue and remit use tax on purchases where no sales tax is charged.

4. Please explain the Department's policy for requesting a statute extension at the beginning of an audit. What is your standardized operating procedure with an audit in this regard?

Auditors conduct examinations of the taxpayer's books and records for state tax purposes and will generally encompass a three year period of time. After initial contact with the taxpayer, a confirmation letter is mailed identifying the agreed upon audit period and an information document request in advance of the on-site examination to facilitate the audit process. It is the examination division's mission to conduct examinations in the most effective, efficient, and professional manner. A waiver of time limitation may be requested at the beginning of the audit period, or during the course of the audit period to preserve the originally agreed upon audit period for any overpayments or underpayments of tax.

5. Please explain the standardized audit field procedures – and the training field auditors receive on these. In this same vein on question, what is the standard procedure we as practitioners should follow if we are representing a client where we see that the auditor is not following your standard auditing procedures?

See Attached PowerPoint.

6. 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?

The Department has a robust fraudulent refund and identity theft detection program. All individual income tax returns pass through a set of over 100 specific criteria using multiple data sources to determine if the filed tax return is fraudulent or additional review of the return and supporting documentation from the taxpayer required. Each year, the criteria is reviewed and updated to identify potential emerging tax fraud and identity theft schemes. Fiscal years ending June 30, 2011 through June 30, 2014, the Examination Division has realized \$62 million in refund tax savings that would have been issued in error if our detection programs were not active. Many identity theft cases originate outside of the State and Country. Recent legislation will allow the Criminal Investigation section to pursue these types of cases going forward. Criminal Investigation has a history of prosecuting for Aiding and Assisting in the Preparation of Fraudulent Tax Returns. This new statute will be an additional deterrent. The Examination and Tax Enforcement (Criminal Investigations) Divisions continue to partner to identify an address fraudulent tax schemes involving identity theft.

### **C. Communications With the Department of Revenue**

1. Has there been any progress made toward the Department implementing a suite of "E-services," like the IRS has as a result of the system upgrade? For example, is there any ability on the near horizon where we as practitioners will be able to obtain transcripts through the website? This capacity is an overwhelming request we hear from our membership.

With the expected implementation of TIMS we were seeking additional functionality as you reference. We still believe taxpayers and CPA's prefer to interact with the Department of Revenue through this channel. Unfortunately, the contract with this vendor was canceled in January of this year. We are asking for a new expenditure in the 2015 legislative session to implement e-services. Exactly what functionality will not be determined until an appropriation is made and cost estimates are received from vendors.

2. Can you please comment on the implementation of the new telephone system? What progress is being made on these 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? We heard that the practitioner line staffing has dropped back to level 2. Is that the official policy now and if so, what procedures do you recommend we follow in situations where we call the practitioner line and need a level 3 "administrative officer?"

All parts of the agency have been on the Avaya telephone system since late 2013.

The new Greensboro call center is expected to be operational after the first of the year. This will enhance the customer service provided by employees at the TACC, the main building and various service centers.

NCDOR continues to provide quality service for our practitioners. Tax Practitioners can call 919-754-2500, between 8:00 a.m. and 5:00 p.m. EST, Monday through Friday, to speak with Department of Revenue tax professionals who can assist them with many of their technical and account specific questions about corporate income and franchise tax, individual income tax, sales and use tax, and withholding tax. Tax

Practitioners calling the (TPPS) Tax Practitioner Priority Service line will ensure they are receiving Level 3 assistance.

3. What is the progress of the new Greensboro call center?

Construction on the new call center began in late September. Positions are being filled and training will occur through December. The target for Go Live is January 2015.

#### **D. Operations**

1. Would the Department be willing to consider ways to enhance efficiency in the tax process associated with timing issues with the federal? Currently, the Department's position seems to be to deny NC refunds when the IRS is still processing the return at the federal level. One of our members had this situation: The federal return was amended because dividend income was reported twice by mistake. The IRS was backlogged and the taxpayer received a 45-day letter from the IRS (stating they are still reviewing and no action is needed). In the meantime, though, the Department denied the state refund. The letter from NC said that the state amended return was being closed due to the IRS not accepting the changes. The IRS did not, however, deny – they just needed more time. Could there be a procedure put into place at the state level to avoid this denial – possibly, also having a state hold put in place that mirrors the federal's 45-day letter?

Yes, the Department would be willing to consider any suggestions to increase our efficiency. No, our current process is not to deny NC refunds when the IRS is still processing the return.

The Examination Division reviews all amended returns filed with the Department, which averages approximately 95,000 amended returns each year. Procedurally, after review of the amended return, if additional documentation is needed to support the return from a non-federal issue, or a review of the IRS Account Transcript does not match the amended return, the auditor will mail the taxpayer a letter requesting specific information. The letter allows the taxpayer 30 days to provide the requested information. The auditor's contact information is furnished within the letter. If the taxpayer communicates to the auditor, indicating additional time is needed to secure and provide the requested information or an amended return has been filed with the IRS but not yet reviewed and processed, the auditor will hold the amended return until documentation is provided or the IRS reviews and approves/denies the amended return. Typically, these cases are placed on hold in 60 day increments, with additional extensions if the taxpayer communicates their progress of

securing documentation or continuing to wait on the IRS to finalize their review of the amended return.

Please be mindful, cases cannot remain open indefinitely without communication to the auditor. If the taxpayer fails to respond to correspondence from the auditor or fails to communicate progress and request additional time, the case will be closed based on the information available. If you have a specific case, where the taxpayer remained in communication with the auditor, and the auditor did not extend the case, please provide the information to Examination Division Director Alan Woodard so we can identify any gaps in our procedures.

2. Would the Department consider, like many other states (VA, GA for example), accepting the federal extension as the state extension in cases where the taxpayer is not sending in money by April 15<sup>th</sup>? Georgia, for example, does accept the federal extension and thus if the taxpayer will not owe money, they do not have to do anything state-level by April 15<sup>th</sup> and if they will owe, they simply send their check with a Georgia payment voucher. Again, we are exploring added efficiency ideas here.

Currently, this feature is not on our road map, but could be a possibility for the future.

3. What is the Department's training procedures for new customer service employees? Specifically, please comment on the level of training a new Level 1 and Level 2 employee receives.

Customer service agents are trained on set a curriculum established for newly hired agents. Customer service agents are offered career advancement from Level 1 to Level 2 when they successfully complete the training progression to advance their knowledge, skills and abilities.

4. Please comment on how the state plans to address issues created by the new HB 27 that the governor signed into law on Aug. 1<sup>st</sup>.

Escheats fall under the responsibility of NC Treasurer's office.

## **E. Suggestions**

1. We realize this is the third year of asking this, but this is the most popular question/request we receive from our members: Is there any hope with the new system that we will be able to receive scanned copies of W-2s that are sent to you? Will the system changes enable the Department anytime soon to be able to scan these source-type documents for later retrieval? K-1 withholding is another example.



We are examining our need for future functionality of equipment as we make requests for equipment and IT funding.

2. Please comment on any restrictions your system has regarding future drafts of estimated payments. One of our members noticed when working with the online payment of NC-40 individual estimated payments that they could not specific a future draft date greater than 60 days from the current date. This may just be a banking restriction.

NCDOR web applications have a 60 day limit for warehousing payments. We are currently making a change in the provider of our payment gateway and they have a limit of 12 months for future draft dates. In January 2015 through the Fed/State process for electronic filing of Individual Income Tax return, the taxpayer will have the option to set up their quarterly estimated tax payments with a date for the money to be drafted from their bank account up to 12 months into the future.

3. Has the Department made any progress on developing and following a consistent policy of always carbon-copying recorded POAs on all correspondence (outside of an active exam situation)? Currently, we are seeing this policy not being consistently followed.

During the development of TIMS, we anticipated that the new system would allow for a consistent method of systemically carbon copying POA's, specifically, notices pertaining to collection proceedings. However, since the new system is now longer in development and due to current system limitations, we are unable to do so at this time.

System generated notices will continue to be mailed to the taxpayer only with the exception of an estate's trustee as designated on the tax form.

The Department continues to require a representative to fill out the Power of Attorney and Declaration Form (Gen-58) for communication purposes.

## **F. Additional Questions**

1. Please explain issues related to returns that are rejected due to “poor print quality, print is too light, print is too small, or print is distorted.”

Based on review of the image of the return mailed back to the taxpayer, there are two areas that would cause problems in recognizing the form. In processing, the software first attempts to recognize the form by reading the barcode. In this image the barcode is not very clear and may not recognize the form type. The next attempt to recognize the form is done

by line geometry. In this image the line geometry is clearly distorted at the top of the page.

NCDOR has instituted a quality check to ensure we are accurately sending back returns that do not meet our checks.

Unfortunately with over 200+ forms going through our data capture equipment, stringent rules are needed for recognizing forms to help us ensure we reach the highest quality in information capture. It is likely that software developer versions of the forms are much easier to capture versus a hand written copy, but the software developer versions also have risks of capturing the wrong data and sending out incorrect refunds and tax due notices.

2. Is there a new policy for the NCDOR to garnish wages when the only amount left to collect is such a minor amount and when it results from a previous payment simply being received late?

The Department uses ITAS for collection case management, which basically moves liabilities through a series of steps until the debt is paid in full or otherwise settled. These steps include: sending a proposed assessment, sending a final bill, contacting the taxpayer via phone, and lastly filing a garnishment if required. This basic process hasn't changed much since we implemented ITAS in 1994, although we have added many new data sources to the garnishment interface. Thresholds for departmental action are continually evaluated.