

SMITH ANDERSON TAX ALERT

Major Tax Legislation Enacted During the Regular Session of the 2017 North Carolina General Assembly

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A previous Tax Alert (June 20, 2017) summarized the tax provisions in the North Carolina 2017 budget bill (the Appropriations Act of 2017¹) as passed by the General Assembly. The Governor later vetoed the budget bill, but the General Assembly overrode the veto, and the budget bill is now law.

In addition to the budget bill, the General Assembly passed the following tax bills before adjourning its regular session earlier today:

Bill Title	Bill Number	Session law
Revenue Laws Technical Changes	H 59	S.L. 2017-39
Equalize Treatment of Wastewater Products	H 548	(Ratified)
Clarify HUT & Improve Vehicle Titling Process	S 326	S.L. 2017-69
Regulatory Reform Act of 2017	S 131	S.L. 2017-10

This Alert supplements the June 20 Tax Alert by summarizing the tax provisions included in all the bills passed during the regular session.²

The most widely discussed tax changes passed during the session included reductions in the corporate and personal income tax rates and an increase in the standard deduction, all to take effect in 2019. In addition, the mill machinery tax has been repealed effective July 1, 2018.

A number of other widely discussed proposals were not enacted. Most notably, the General Assembly did not enact the provision included in the Senate budget bill that would have adopted market-based sourcing for apportioning receipts from services and intangibles. As a result, multi-state taxpayers will continue to use the income-producing activities method of sourcing service receipts despite the full implementation of single sales factor apportionment in 2018. In addition, the following provisions included in the House budget bill were not enacted:

- an increase in the cap on the itemized deductions for mortgage interest and property taxes,
- a reduction in the franchise tax rate, and
- a sales tax refund for R&D supplies.

In addition, S 628, an omnibus tax bill making numerous technical and other changes, was sent to a conference committee but was not reported out before the session ended. The General Assembly will reconvene August 3, 2017, and it is expected that this bill will be taken up then. Among the bill's provisions are:

- numerous clarifications to the sales taxation of repair, maintenance and installation services;
- a limited restoration of the franchise tax deduction for real property indebtedness in computing the total actual investment in tangible property tax base;
- a change to the corporate income tax net interest expense deduction limitation;
- various changes to the taxation of captive insurance companies; and
- changes to the procedures for the Departmental review of proposed assessments and proposed refund request denials aimed at reducing the number of taxpayer conferences.

Finally, S 81, an economic nexus bill that would have asserted sales tax nexus over any retailer making remote sales into the state that exceeded either \$100,000 in gross sales or 200 separate transactions, did not pass.

The discussion below briefly summarizes each major change and indicates the effective date and the ratified bill number (for unsigned bills) or session law number (for bills already signed by the Governor) of the enacting

¹ S 257; S.L. 2017-57.

² In addition to the bills mentioned above, S 68 (S.L. 2017-6) recodified certain chapters of the General Statutes to create a new Chapter 163A to be known as the Elections and Ethics Enforcement Act. Certain cross-references to the recodified provisions found in Chapter 105 were updated to reflect the recodification.

legislation. Readers should note that ratified bills not yet signed by the Governor will become effective only when signed or if the Governor fails to veto them within 30 days after adjournment.

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IRC CONFORMITY

Each year the General Assembly updates the reference to the Internal Revenue Code (IRC) found in Chapter 105 of the General Statutes in order to conform to recent federal tax legislation.³ This year, the IRC reference has been updated from January 1, 2016 to January 1, 2017, effective June 21, 2017.⁴ As a result, North Carolina conforms to IRC amendments made by the following federal acts amending the IRC in 2016:

Public Law No.	Title	Date of Enactment
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³ See G.S. §105-228.90(b)(1b).

⁴ S.L. 2017-39, §§1 and 17.

114-125	Trade Facilitation and Trade Enforcement Act of 2015	February 24, 2016
114-141	Airport and Airway Extension Act of 2016	March 30, 2016
114-184	Recovering Missing Children Act	June 30, 2016
114-190	FAA Extension, Safety, and Security Act of 2016	July 15, 2016
114-239	U.S. Appreciation for Olympians and Paralympians Act of 2016	October 7, 2016
114-255	21 st Century Cures Act	December 31, 2016
114-328	National Defense Authorization Act for Fiscal Year 2017	December 23, 2016

PERSONAL INCOME TAX CHANGES

Rate Reduction

The personal income tax rate has been reduced from 5.499% to 5.25% 257 for taxable years beginning on or after January 1, 2019.⁵

Increase in Standard Deduction

The standard deduction has been increased from \$17,500 to \$20,000 for joint filers, from \$14,000 to \$15,000 for heads of households, and from \$8,750 to \$10,000 for single filers and married taxpayers filing separately, effective for taxable years beginning on or after January 1, 2019.⁶

Conversion of Child Care Tax Credit

The child care tax credit has been repealed and replaced with a deduction for child care expenses, effective for taxable years beginning on or after January 1, 2018. The deduction starts at \$2,500 and is reduced to \$2,000 for joint filers with over \$40,000 in AGI, to \$1,500 for joint filers with over \$60,000 in AGI, to \$1,000 for joint filers with over \$80,000 in AGI, to \$500 for joint filers with over \$100,000 in AGI and to zero for joint filers with over \$120,000 in AGI. Similar phase outs are provided for other types of filers.⁷

CORPORATE INCOME AND FRANCHISE TAX CHANGES

Rate Reduction

In 2015, the General Assembly reduced the corporate income tax rate from 5% to 4% and provided for a further decrease to 3% if a General Fund revenue target was met. That rate reduction trigger was met, and the rate dropped to 3% in 2017. The corporate income tax rate is further reduced to 2.5% for taxable years beginning on or after January 1, 2019.⁸

Cap on Franchise Tax for Small S Corporations

Under current law, both C and S corporations are subject to the general franchise tax at the rate of \$1.50 per \$1,000 of tax base.⁹ LLCs generally are not subject to the franchise tax but are instead subject to a \$200 annual report fee.¹⁰ Under new legislation S Corporations will be subject to a flat \$200 franchise tax on the first \$1 million of franchise tax base. The normal rate of \$1.50 per \$1,000 of tax base will apply to an S corporation's tax base in excess of \$1 million. This change is effective for taxable years beginning on or after January 1, 2019 and is applicable to calculation of the franchise tax reported on the 2018 (and later) corporate income tax return.¹¹

CHANGES TO CREDITS AND INCENTIVES

Railroad Intermodal Facility Tax Credit Changes

Current law provides a credit equal to 50% of the cost of constructing an eligible railroad intermodal facility.¹² This credit has been amended to provide that the credit is not allowed to the extent public funds are used in constructing

⁵ S.L. 2017-57, § 38.1; G.S. §105-153.7(a).

⁶ S.L. 2017-57, § 38.2; G.S. §105-153.5(a)(1).

⁷ S.L. 2017-57, § 38.4; G.S. §105-153.5.

⁸ S.L. 2017-57, § 38.5; G.S. §105-130.3.

⁹ G.S. §105-122.

¹⁰ G.S. §57D-1-22(a)(28).

¹¹ S.L. 2017-57, § 38.6; G.S. §105-122.

¹² G.S. §105-129.96.

the facility.¹³ In addition, because the credit is allowed either to the owner or the lessee of the facility, the credit has been amended to provide that a lessee may claim the credit only if the owner provides a written certification that it will not claim the credit.¹⁴ These changes are effective for taxable years beginning on or after January 1, 2017.¹⁵

Renewable Energy Tax Credit Changes

The General Assembly repealed North Carolina's renewable energy tax credits, effective January 1, 2016, but extended the sunset to January 1, 2017 for 65 megawatt or larger projects that were 50% complete by January 1, 2016 and for smaller projects that were 80% complete by that date.¹⁶ The sunset has been further extended to May 5, 2017 for renewable energy property using renewable biomass resources.¹⁷ This change is effective July 1, 2017.¹⁸

Economic Incentive Sales Tax Refunds

Professional motorsports racing teams and sanctioning bodies are allowed a sales tax refund on purchases of certain fuel.¹⁹ The previous refund provision erroneously referred to "aviation fuel," an undefined term. This error has been corrected.²⁰ The refund provision now applies to purchases of "aviation gasoline" and "jet fuel," both defined terms.²¹ This change is effective June 21, 2017.²²

MILL MACHINERY AND SALES TAX CHANGES

Repeal of Mill Machinery Tax

Article 5F of Subchapter I of Chapter 105 of the General Statutes has been repealed effective July 1, 2018.²³ Article 5F currently imposed a 1% tax with an \$80 per article cap on mill machinery purchased by a manufacturing industry or plant as well as on certain equipment purchased by (i) major recycling facilities, (ii) certain R&D companies, (iii) certain software publishers, (iv) certain industrial machinery refurbishers, (v) certain port facility handlers, (vi) certain secondary metals recyclers, (vi) certain precious metal extractors and (vii) certain metal work fabricators.²⁴ The sales and use tax exemptions for items "taxable under Article 5F" have also been repealed effective July 1, 2018.²⁵

Sales Tax Exemption for Mill Machinery

New sales and use tax exemptions have been enacted to cover items formerly taxable under Article 5F, effective July 1, 2018.²⁶ The language of these new sales tax exemptions is substantively identical to the language of the former Article 5F provisions, except that one requirement currently applicable to purchases by R&D companies, software publishers and industrial machinery refurbishers has been eliminated. Under current law, items purchased by these taxpayers are covered by Article 5F only if they would have been considered mill machinery if they had been purchased by a manufacturing industry or plant.²⁷ This requirement has not been carried over to the new sales tax exemptions.

Revenue Laws Study Committee Study

The General Assembly acknowledged that it has never defined the terms "manufacturing industry or plant" or "mill machinery" and that the Department of Revenue has developed a substantial body of administrative interpretations of these terms. The legislature has directed the Revenue Laws Study Committee to study "ways in which to clarify the scope of the sales and use tax exemption for mill machinery" by "modernizing and further defining the statutory

¹³ S.L. 2017-39, §3.(a).

¹⁴ *Id.*

¹⁵ S.L. 2017-39, §3.(b).

¹⁶ G.S. §105-129.16A(f).

¹⁷ S.L. 2017-57, § 38.13.

¹⁸ S.L. 2017-57, §39.7.

¹⁹ G.S. §105-164.14A(a)(4).

²⁰ S.L. 2017-39, §7.

²¹ G.S. §105-164.3(1h) and (16b).

²² S.L. 2017-39, §17.

²³ S.L. 2017-57, § 38.8.(a) and (f).

²⁴ See G.S. §§105-187.50 – 105-187.53.

²⁵ S.L. 2017-57, §38.8.(a). See also S.L. 2017-57, §38.8.(b) repealing the exemption for service contracts on items taxed under Article 5F.

²⁶ S.L. 2017-57, §38.8.(c) and (f); G.S. §105-164.13(5e), (5f), (5g), (5h), (5i), (5j), (5k), (5l), and (5m).

²⁷ See G.S. §§105-187.51B(a)(2)c, 105-187.51B(a)(3)c, and 105-187.51B(a)(4)c.

language and by incorporating existing administrative interpretations of the Department of Revenue, to the extent the General Assembly desires to maintain those interpretations.” The Committee “may,” but apparently is not required, to report its findings and any recommended legislation to the 2018 Regular Session of the 2017 General Assembly.²⁸

Sales Tax Exemption for Ready-mix Concrete Mills

A new sales and use tax exemption has been enacted for sales of repair or replacement parts for ready-mix concrete mills if the purchaser is primarily engaged in the sale of ready-mix concrete.²⁹ The exemption applies to both freestanding mills and mills affixed to a motor vehicle.³⁰ This exemption is effective July 1, 2018.³¹

Exemption for Wastewater Dispersal Products

Under prior law, sales of products made of recycled materials for use in an accepted wastewater dispersal system were exempt from sales and use tax. This exemption has been modified to cover any wastewater dispersal product approved by the North Carolina Department of Health and Human Services, whether or not made of recycled materials.³² This change is effective for sales made on or after July 1, 2017.³³

Definitional Changes

The definition of “protective equipment” found in G.S. §105-164.13(31) has been repealed.³⁴ The definition related to a sales tax holiday that was repealed in 2013.³⁵

The definition of the Streamlined Sales and Use Tax Agreement has been updated to refer to the version of the agreement dated December 16, 2016.³⁶ This change is effective June 21, 2017.³⁷

Exemption for Large Fulfillment Centers

A new sales and use tax exemption has been enacted for sales of equipment, including accessories, attachments and repair parts, sold to a “large fulfillment facility” and used at the facility in the distribution process. The exemption does not apply to electricity. A “large fulfillment facility” is defined as a facility used primarily for receiving, inventorying, sorting, repackaging and distributing finished retail products for the purpose of fulfilling customer orders. To qualify for the exemption, the Secretary of Commerce must certify that at least \$100 million in private funds will be invested in the project within a five-year period and that at least 400 people will be employed at the facility. The exemption is forfeited if the investment and employment requirements are not satisfied. This provision is effective July 1, 2017.³⁸

Refund for Transformative Projects

North Carolina’s Job Development Investment Grant (“JDIG”) program has been amended to provide additional incentives for “transformative projects.” A transformative project is defined as a project requiring an investment of at least \$4 billion and the creation of at least 5,000 jobs.³⁹ In addition, the owner or lessee of a business that receives a JDIG grant for a transformative project is entitled to a refund of sales tax paid or indirectly incurred on building materials, building supplies, fixtures and equipment that become a part of the real property of the facility.⁴⁰ This provision is effective July 1, 2017.⁴¹ This provision is believed to target a proposed Foxconn manufacturing facility the state is hoping to recruit.

PRIVILEGE LICENSE TAX CHANGE

²⁸ S.L. 2017-57, §38.8.(e).

²⁹ S.L. 2017-57, §38.8.(c), adding new G.S. §105-164.13(5n).

³⁰ *Id.*

³¹ S.L. 2017-57, §38.8.(f).

³² H 548, §1; G.S. §105-164.13(68).

³³ H 548, §4.

³⁴ S.L. 2017-39, §5.

³⁵ See G.S. §105-164.3C (2013) and S.L. 2013-316, §3.4.(a).

³⁶ S.L. 2017-39, §5; G.S. §105-164.3(45a).

³⁷ S.L. 2017-39, §17.

³⁸ S.L. 2017-57, §38.9; G.S. §§105-164.13(5o) and 105-164.3(16f).

³⁹ S.L. 2017-57, §15.15A; G.S. §143B-437.51(9a).

⁴⁰ S.L. 2017-57, §38.9A; G.S. §105-164.14A(a)(8).

⁴¹ S.L. 2017-57, §38.9A.(b).

Under prior law, licensed “morticians” and “embalmers” were required to obtain a \$50 annual privilege license tax from the Department of Revenue.⁴² The statute has been amended to refer to a “funeral director, embalmer or funeral service licensee.”⁴³ This change conforms the language of the privilege license tax statute to that of the licensing statute.⁴⁴ This change is effective June 21, 2017.⁴⁵

TOBACCO PRODUCT TAX CHANGE

Under existing law, sellers of cigarettes and other tobacco products are required to be licensed,⁴⁶ but the provision making it unlawful to maintain an unlicensed place of business referred only to cigarette sellers.⁴⁷ The statute has been amended to refer to sellers of cigarettes or other tobacco products.⁴⁸ This change is effective June 21, 2017.⁴⁹

HIGHWAY USE TAX CHANGE

Under existing law, full exemptions from the highway use tax are provided for certificates of title issued to (1) insurers and used car dealers with respect to salvaged vehicles, (2) manufacturers and retailers for the purpose of resale, (3) the same owner to reflect a name change, (4) one or more co-owners to reflect a change in co-ownership without consideration, (5) a transferee by will or intestate succession, (6) the donee of an interfamily gift, (7) a transferee to reflect a transfer incident to divorce, (8) a local board of education for driver training purposes, (9) a volunteer fire department, (10) certain state agencies and (11) a revocable trust from the sole beneficiary. In addition, a partial exemption is allowed for certificates of title issued to reflect the perfection of a security interest or certain nonrecognition transactions.⁵⁰ The statute has been amended to provide that the full and partial exemptions (other than the full exemptions described in (1), (2), (9) and (10) above) do not apply when the vehicle is titled in another state at the time of transfer.⁵¹ This change is effective June 28, 2017.⁵²

PROPERTY TAX CHANGE

Under current law, antique automobiles are designated a special class of property and are assessed at the lower of fair market value or \$500.⁵³ In order to qualify for the designation, the automobile must be owned by an individual.⁵⁴ This requirement has been changed to permit qualification for the reduced assessment where the vehicle is owned by an individual either directly or indirectly through one or more pass-through entities.⁵⁵ This change became effective May 1, 2017.⁵⁶

MOTOR FUEL TAX CHANGES

The following changes to the Motor Fuel Tax statutes were effective June 21, 2017.⁵⁷

The reference to the International Fuel Tax Agreement has been updated from July 1, 2013 to January 1, 2017.⁵⁸

A number of definitions have been added or amended. Specifically: (1) the term “bulk storage” has been defined as a container or tank used to store bulk purchases of at least 42 gallons of motor fuel or alternative fuel; (2) the definition of “diversion” has been amended to eliminate the requirement that motor fuel be moved “from a terminal” to a state other than the destination state named in the bill of lading; (3) the definition of a fuel alcohol provider has been amended to eliminate the requirement that an importer import fuel “outside the terminal transfer system” and to

⁴² G.S. §105-41(a)(11).

⁴³ S.L. 2017-39, §9.

⁴⁴ See G.S. 90-210.25.

⁴⁵ S.L. 2017-39, §17.

⁴⁶ G.S. §§105-113.11 (cigarettes) and 105-113.36 (other tobacco products).

⁴⁷ G.S. §105-113.29.

⁴⁸ S.L. 2017-39, §10.

⁴⁹ S.L. 2017-39, §17.

⁵⁰ G.S. §105-187.6.

⁵¹ S.L. 2017-69, §1.

⁵² S.L. 2017-69, §3.

⁵³ G.S. §105-330.9.

⁵⁴ *Id.*

⁵⁵ S.L. 2017-10, §2.8.

⁵⁶ S.L. 2017-10, §22.

⁵⁷ S.L. 2017-39, §17.

⁵⁸ S.L. 2017-39, §11; G.S. §105-449.37(a)(1).

expand the term to include an importer who imports fuel alcohol using a marine vessel; (4) the definition of gasoline has been amended to add the requirements that the product be listed in Treasury Regulation section 48-4081-1(c)(3) as of January 1, 2017 and that it be able to be blended for use in a motor fuel; (5) the definition of supplier has been amended to omit “refiners” from the definition; and (6) the definition of system transfer has been amended to omit a transfer of fuel grade ethanol by transport truck or railroad tank car.⁵⁹

The licensing requirement applicable to persons engaged in more than one activity requiring a license has been amended. The statute previously provided that a person licensed as a supplier was considered to have a license as a blender only if the person was a biodiesel provider.⁶⁰ The requirement that the person be a biodiesel provider has been eliminated.⁶¹

The requirement that applicants for export licenses designate an agent for service of process in North Carolina has been eliminated.⁶²

The excise tax on fuel grade ethanol and biodiesel fuel has been amended. Previously, the tax applied to fuel grade ethanol or biodiesel fuel imported into North Carolina outside the terminal transfer system.⁶³ As amended, the tax applies to such products imported using a transport truck, railroad tank car, tank wagon or marine vessel.⁶⁴

ADMINISTRATIVE CHANGES

Federal Changes

The circumstances in which a taxpayer must report a federal change have been expanded. Under prior law, a corporate taxpayer was required to report a federal correction to its “federal taxable income.”⁶⁵ Under the new law, the taxpayer must also report any change to a federal credit that affects the amount of its state tax liability.⁶⁶ Similarly, under prior law, an individual taxpayer was required to report a federal change to “federal adjusted gross income or federal credit that affects the amount of state tax payable.”⁶⁷ Under the new law, the taxpayer must also report any change to his or her filing status, personal exemptions or standard or itemized deductions.⁶⁸ These changes are effective June 21, 2017.⁶⁹

Sales Tax Registration

The sales tax registration requirements have been amended to clarify that any facilitator liable for tax under Article 5 must register with the Department of Revenue. Under former law, only accommodation rental facilitators under G.S. §105-164.4F were required to register.⁷⁰ Under the new law, all facilitators, including entertainment activity facilitators under G.S. §105-164.4G, must register.⁷¹ This change is effective June 21, 2017.⁷²

A sales tax registration typically becomes void if no returns are filed or no sales are reported for a period of eighteen months.⁷³ An amendment provides an exception to this rule where the registered seller has contracted with another person to collect and remit sales taxes and that other person is a certified service provider under the Streamlined Sales and Use Tax Agreement.⁷⁴ This change is effective June 21, 2017.⁷⁵

⁵⁹ S.L. 2017-39, §12; G.S. §105-449.60.

⁶⁰ G.S. §105-449.65(b).

⁶¹ S.L. 2017-39, §13.

⁶² S.L. 2017-39, §14; G.S. §449.69(e).

⁶³ G.S. §105-449.81(3b)b.

⁶⁴ S.L. 2017-39, §15.

⁶⁵ G.S. §105-130.20.

⁶⁶ S.L. 2017-39, §4.(a).

⁶⁷ G.S. §105-159.

⁶⁸ S.L. 2017-39, §4.(b).

⁶⁹ S.L. 2017-39, §17.

⁷⁰ G.S. §§105-164.6(f)(2) and 105-164.29(a).

⁷¹ S.L. 2017-39, §§6 and 8.

⁷² S.L. 2017-39, §17.

⁷³ G.S. §105-164.29(c).

⁷⁴ S.L. 2017-39, §8.

⁷⁵ S.L. 2017-39, §17.