

Questions for Discussion with NC Department of Revenue
Submitted by the NC Association of CPAs Committee on Taxation
and the Tax Section of the NC Bar Association

December 4, 2017

Individual Income Tax Issues

1. It appears that federal tax return transcripts only reflect info for original filings (or Substitute for Return), despite amendments. Any subsequent amendments, etc. only are shown in the account detail, but not the transcript. The issue arose this way: A client had identity theft and someone filed a fraudulent return in their name for 2014. We discovered this when we tried to e-file, and so the client had to paper-file. Sometime later, the client amended that return. The IRS processed the paper return and the amendment with no problem, but NC did not. NC is requiring an IRS transcript before NC will accept anything other than the fraudulent return, and in fact NC has assessed based on the fraudulent return. NC has asked us for a transcript, but the IRS transcript only shows the fraudulent info, which of course agrees with the NC assessment. The question for NC is how are we supposed to correct and stop assessment on a fraudulent return?

In order to provide a more responsive answer to the question, we would require the specific set of facts related to this taxpayer. However, if the Examination Division or Office of Taxpayer Advocate determines identity theft refund fraud, the taxpayer's account is placed in a hold status, which requires a staff member to manually review any transaction or activity within the account for the purpose of avoiding a potential assessment to the real taxpayer or issuance of a fraudulent refund. A specific identity theft unit has been established with the Office of Taxpayer Advocate to aid victims of identity theft. The preparer or the taxpayer should call our Identity Theft Unit at 919-715-0195 to facilitate the process associated with fraudulent tax returns filed as a result of identity theft. During this process, it would be helpful if the taxpayer will provide the account transcript, which reflects any adjustments to the original return.

2. From a Charlotte area CPA: My understanding is that NC is still holding onto known overpayments and will not process a refund automatically. I had a phone agent tell me this directly last year. If there is a math or return error, they seem to correct it automatically. But if you double pay an extension, for instance, they won't return the 2nd payment unless you catch it and contact them. This has been mentioned in prior years and practitioners still have these problems. What can practitioners do to alleviate this problem? And what can NCDR do to make CPAs feel this is not a reality?

In the example you present above, it appears the taxpayer has submitted two payments to be applied to their individual income tax liability with an extension of time to file individual income tax form. Our system simply recognizes this transaction as two payments for the tax year indicated on the extension form and are posted to our Integrated Tax Administration System under the taxpayer's identifying number as a payment with extension. An overpayment or underpayment cannot be determined until the individual income tax return is filed and posted to the system. When the return is posted, the system automatically applies the payments submitted with the extension to the taxpayer's liability as reflected on the filed return and determines if the account balances, or the account is overpaid or underpaid. Underpayment of the account will result in issuance of an assessment, overpayment will result in a refund issued to the taxpayer.

3. On the NC Form D-400V Individual Income Tax payment voucher, there is a place on the form for the name of the "Taxpayer / Paid Preparer". How is this information being used and has this proved useful?

Our Submission Processing Division may utilize this information to contact the taxpayer or preparer if the payment is unable to process.

4. Taxpayer set up his estimated tax payment online to be automatically withdrawn from his bank account. First, he would prefer to set up all his estimated tax payments for the year at one time instead of having to go into the system each quarter to enter his payment. Second, when he entered his payment for one quarter, he entered a digit of his bank account number erroneously so his payment was not withdrawn from his account. Taxpayer did not realize this until after filing his 2016 tax return when he received a notice from NCDOR that the payments claimed on the return did not match payments in the NCDOR system. Could NCDOR contact taxpayer in situations like this when a payment request is rejected to make the correction timelier?

When filing using an eFile Provider (Mef) at the time the return is filed, the taxpayer can schedule all 4 estimated payments. Not all eFile Providers support payments or Estimated payments. The only payment validation done at the time that payment is submitted is on the routing number- not on the bank account number. We could possibly work with those that are not supporting this to include it in the future.

If they are submitting an estimated payment online via the NCDOR website (OFP), payments can be scheduled 60 days in advance (this is the current business rule not a technical limitation). Validation is done on the routing number, but not on the bank account number (although we prompt them to key it twice). We could extend the draft date time limit on estimated payments out far enough to enable the taxpayer to submit for the year.

PayPoint is our payment processor for e-pay. Some validation is done the night before settlement date. Therefore, we are notified of a few payments daily (that were postdated) that failed to draft from accounts for various reasons (not bank accounts). We do call on these and inform the taxpayer of the issue and that they need to resubmit.

However, the bank account number cannot be validated until you actually send the transaction to the bank. For payments that return from the bank unpaid (such as NSF, no account existence, etc.), we are notified to process the returned payment. Those are basically backed out of the posting system (and depending on the reason, a Bad Payment Penalty applied). We stopped calling taxpayers on returned payments many years ago because it became unreasonable with 1,000's of returned payments received in a day during peaks... and most banks notify their customers of returned payments. This includes paper checks and e-payments. Because this is a business process we could look at ways to improve the process.

5. What is the purpose of the new question on individual tax returns; Are you a veteran? Many clients want to know why the government is asking, especially since there is no apparent tax credit, etc. if the taxpayer is a veteran. How will this information be used and what have you learned from the answers received?

The 2016 Session of the North Carolina General Assembly enacted S.L. 2016-112 that requires the Secretary of Revenue to annually compile information about the number of veterans filing individual income tax returns in North Carolina and to provide this information to the Department of Military and Veterans Affairs no later than January 15 of each year. Any information that is collected from taxpayers is confidential in accordance with G.S. 105-259.

Of note, S.L. 2016-112 specifically states in pertinent part:

“[V]eteran status is ...requested to assist the State in documenting the importance and impact of the State’s military population in our communities and on our State and local economies...”

6. What is the status of the study to allow federal extensions as a substitute for NC extensions (as provided in SB 628)?

Over the past few months, representatives from the Department have contacted several states that currently allow federal extensions as a substitute for that state’s extension. The Department is currently analyzing those states’ responses to the Department’s inquiries. The Department will report its findings, along with any legislative recommendations, to the Revenue Laws Study Committee by January 1, 2018.

Is there any possibility federal extensions will be accepted prior to January 1, 2019?

Because legislative action may be needed, the Department will not implement any changes to the processing of North Carolina extensions until after the 2018 legislative session. If legislative changes do occur, the General Assembly will determine the effective date of the law change.

Is consideration being given to not requiring any extension form to be filed if the taxpayer expects to not owe additional tax?

The Department is aware of several states that do not require a taxpayer to file an extension form if the taxpayer expects to not owe additional tax. As stated above, the Department will report its findings along with any legislative recommendations, to the Revenue Laws Study Committee by January 1, 2018.

7. This question concerns situations where the IRS has reported a change to taxpayer's income following a CP2000 notice. Apparently the IRS is reporting the change to NCDR before final resolution of the matter is reached with the taxpayer. We have had taxpayers receive notices from the NCDR of proposed changes and an assessment of tax. A similar situation might occur after an IRS audit or during an IRS audit reconsideration. What is the NCDR policy for deferring collection action until the matter is resolved with the IRS (which unfortunately may take many months). We have had instances where the NCDR agreed to stay collection action, and others where NCDR demanded payment and then refunded the tax once the taxpayer received a favorable determination from the IRS. This can be quite burdensome to the taxpayer to make this payment of tax when they do not owe.

The Examination, Collection and Taxpayer Assistance Divisions has had a Memorandum of Understanding for many years which indicates a Revenue Officer will contact the Examination Division with respect to a forced collection case whereby the taxpayer indicates an amended return has been filed. The Revenue Officer will hold collection activity and the Examination Division will work the amended audit within 4 hours to determine if the amended return reconciles the assessment or if an underpayment remains. Any overpayment that exists after the amended return will be refunded to the taxpayer if the period remains within the statute of limitations.

Business Income Tax Issues

1. When a partnership is filing its NC return electronically and has a payment due (usually due to nonresident partners), there is no form to accompany the payment. Is there a voucher or other form that NCDR can create or already has that can be used to accompany this payment to provide some assurance that the payment will be posted correctly?

The Department provides a voucher to partnerships that elect to electronically file partnership returns but choose not to pay the tax due electronically. Form D-403V, Partnership Income Payment Voucher, is available from the Department's website. Simply go to www.dornnc.com and search for "partnership income payment voucher."

2. Will NCDR allow overpayments of franchise tax and composite income tax by S Corporations to be applied to the next year? This would be more efficient for taxpayers and practitioners and maybe NCDR as well.

Prior to tax year 2014, the "Tax Due or Refund" section of the CD-401S included a line for the taxpayer to indicate the amount of an overpayment of income and/or franchise tax to be applied to estimated income tax for the next year, similar to the corresponding section of the C-Corporation form, CD-405. It came to the Department's attention that N.C. Gen. Stat. 105-131.1(a) specifically states that S-Corporations are not subject to income tax imposed under N.C. Gen. Stat. 105-130.3. Therefore, no estimated payments are required. Neither is there any provision in Article 3 for estimated payments of franchise tax. Therefore, the line was removed.

3. Several firms report problems filing S Corporation and partnership returns electronically for 2016 because the ownership percentages did not precisely equal 100%. For example, an S Corporation with three shareholders owning 100 share each was rejected due to this percentage issue. Is this a problem within the NCDR e-filing system or is this in the firm's software? There are no such problems filing federal returns like this electronically.

After reviewing the current business rules, the Department has decided to modify the rule that caused the returns mentioned above to reject. For tax year 2017, the rule will include a rounding tolerance.

4. Several firms report that attempts to qualify partnership returns for electronic filing failed due to the lack of apportionment data in Part 2 of Form D-403 although this business operates entirely within NC and the apportionment factor (if computed) would be 100% to NC. Is this a problem within the NCDR e-filing system or is this in the firm's software?

After reviewing the current business rules, the Department has decided to suspend the rule that caused the returns mentioned above to reject for tax year 2017.

Note. For 2018, the Department plans to modify Form D-403, Part 2 to add a new section. This new section will account for partnerships that only do business in North Carolina. After modification, the apportionment schedule should more closely resemble the apportionment schedule currently found on the North Carolina S-corporation tax return. See 2016 Form CD-401S, Page 7, Schedule 0, Part 1

5. A number of practitioners have complained about the lack of relief available to taxpayers who failed to file Form CD-400 MS, regardless of the reasonableness for their failure. Please see Section 32.14A(e) of H259 which states "The Secretary may reduce or waive the penalty as provided in G.S. 105-237." We believe this indicates that the Legislature anticipated the need for reduction or waiver in some circumstances. We understand that some penalties have been reduced by \$1,000 if the request was made prior to August 15, 2017. Has full penalty relief been granted in any cases? What were those circumstances?

Waiver of penalty is at the discretion of the Secretary. Before any penalty notices were sent to taxpayers, the Secretary determined that waiving the failure to file penalty for the CD-400 MS would not be fair to the many taxpayers who timely filed the form. In August 2017, the Secretary reconsidered his position and reduced the penalty to \$1,000 if a taxpayer filed the form and requested waiver by August 15, 2017. The Corporate Division has strictly adhered to that direction. Penalties have been abated when it was determined that the taxpayer did not meet the requirements for filing the informational report.

6. Some practitioners have indicated an unusual number of notices have been received indicating that there is no record of a 2012 Corporate Franchise Tax Return being filed. These appear to have been sent in error. Can you comment on this?

The Department makes every effort to ensure that corporations are not suspended in error. Corporations may register with Secretary of State under their legal name and file returns under a different name such as a trade name or DBA. Slight variations in name will prevent successful matching and may result in a corporation being suspended in error. If you believe your client has been suspended in error, please contact (877) 919-1819 ext. 1120406.

Sales and Use Tax Issues

1. Practitioners continue to seek more explanation and examples in order to apply the RMI rules as best they can. We understand that an update is planned for the taxability matrix published in March 2017. What further notices or updates are planned to further explain these rules for taxpayers and practitioners?

Form E-505, which provides an overview of the key sales and use tax legislative changes was published by the Department in September 2017. This document is mailed to each registered taxpayer and also sent via email to the last email address used to file an electronic sales and use tax return.

Additionally, the Department will publish its 2017 annual law change publication that includes explanations for all changes for laws administered by the Department.

In addition to updating the matrix that identifies by category items/transactions that are generally capital improvements or taxable/exempt repair, maintenance, and installation services, the Sales and Use Tax Division is in the process of creating new Sales and Use Tax Bulletins that will include on current law and applications at the time of publishing. The target date for issuance is January 2018.

The Division is in the process of updating Form, E-589CI, Affidavit of Capital Improvement, as a result of changes regarding liability where the form is issued by a person to substantiate that a transaction is a capital improvement and a transaction therefore should be taxed as a real property contract for sales and use tax purposes. Along with the updated Form E-589CI, an important notice or other publication will be issued to highlight the key changes to the form.

No other items are planned at this time relative to real property contracts and repair, maintenance, and installation services for real property.

2. A practitioner presented a number of e-mails, NCDR notices, and other correspondence with NCDR concerning the requirement that a first time refund filer must submit all invoices for the refund period. In this case, there were approximately 65,000 invoices that had to be assembled and submitted. Is it not more realistic to allow some sampling in a case like this?

In order to provide a more responsive answer to the question, we would require the specific set of facts related to this taxpayer. Generally, Examination Division policy and procedure is to verify the claim for refund, in an efficient manner utilizing the most efficient method to ensure the refund request is accurate. Dependent upon the number of documents associated with the claim, our auditors may review all invoices, request a limited number of invoices from a block sample period, or request an electronic download of the documents to pull a stratified statistical sample and request a limited number of invoices from each stratum.

Other Questions and Issues

1. Will e-filing of fiduciary returns be available for the 2017 return filing season?

The Department will not be offering electronic filing of fiduciary returns for tax year 2017; however, we are planning to expand our electronic filing options to include fiduciary returns in the future.

2. Will you share your recommendations for tax law changes that have been, or would be, offered to the legislature? The NCACPA is getting more involved with the members of the legislature and there may be some opportunities for us to advance your recommendations.

The Department is currently in the process of compiling our list of recommendations for the next session. Once that list is finalized we will engage the NCACPA when appropriate. The DOR always welcomes suggestions from the NCACPA. Our goal is to make voluntary compliance as efficient as possible.

3. Practitioners continue to ask about getting copies of notices when a POA is on file. What can the NCACPA do to help make this a reality?

Currently, our Integrated Tax Administration System does not support this capability; however, the DOR understands the business need and will continue to research options.

4. What is the proper procedure for elevating a question raised to a person reached on the Practitioner Priority Service telephone line to another person at a higher level of expertise?

The Practitioner Priority Service telephone line is answered by the Taxpayer Assistance Division employees with the most technical tax knowledge. If for some reason the employee answering the call cannot answer the question, the employee will take the name and number of the caller and consult with Tax Administration. After consulting with Tax Administration, the TPA employee will return the call and provide the answer.

5. Why can't I fax a Gen58 directly to somebody in collections? We had a case last week where a garnishment was issued, it was about to take effect, and the client came in a week before pay day. It takes several days for the release of garnishment to be generated and received, so I need to take some action ASAP. I faxed over the Gen58, but it takes several days to process. So I called the number on the notice, trying to make a down payment and start an IA to avoid the garnishment, and they refused to speak with me because the Gen58 was not processed. In the past in that situation I have been able to fax a copy of the Gen58 to the representative and then deal with them over the phone, but this time they refused, and the manager also refused to accept it. I was trying to both pay the NCDR and keep my

client's life from being disrupted by a garnishment, and they wouldn't talk to me without the client actually on the same line. This is extremely inefficient for all parties.

If a taxpayer or their representative is working with a specific revenue officer in one of the Department's service centers, the GEN-58 can be faxed to that service center to the attention of the assigned revenue officer. A complete list of office locations with telephone/fax numbers can be found by visiting www.dornrc.com/collect/service_center_map.pdf.

If the taxpayer or their representative is contacting the Department through the Contact Center, call agents will request that the form be faxed to (919) 715-1786. Once the fax is received, POAs are reviewed to ensure they have been properly completed and a note is logged on the taxpayer's account. The processing time ranges between 24-48 hours depending on volume. In the event a taxpayer/representative calls with a time sensitive matter, the call agent will request that the representative and taxpayer be on the line to obtain verbal authorization.

6. Taxpayer has open tax obligations for several years. Taxpayer has a source of funds, from a non-liable party, and wishes to make designated payments to the tax for the most recent unpaid year. NCDR refused to accept the designated payments and informs us they will ignore any designated restrictions on the endorsement section on a check or similar provisions in a transmittal letter. NCDR stated all payments, denoted as designated or not, will be applied to the best interest of the department. Is this the policy of the NCDR?

The Department should apply a payment to the unpaid period designated by the taxpayer or their representative. However, in the absence of a specific designation, the Department will apply the payment to the oldest unpaid liability. This is done to benefit the taxpayer as interest continues to accrue on the balance of outstanding tax.

7. Is it NCDR policy to reject Offers in Compromise where the underlying obligation is a trust fund assessment? My experience indicates this may be the case. NCDR rejected an OIC even though IRS had accepted an OIC on lesser terms, non-liable party was supplying the funds, the collections statute of limitation was due to expire within 24 months, the offered amount exceeded the amount collectible through existing garnishments and the taxpayer had no equity in other assets.

The Department has no policy that prohibits the acceptance of Offers in Compromise where the underlying obligation is a trust fund assessment. Each Offer in Compromise is evaluated individually based on the circumstances surrounding the liability and the taxpayer's financial ability to pay. For an offer to be accepted, the Department must find that compromise is in the best interest of the state.

8. Is there a source of concise explanations of collections policies & procedures?

Collection Division policies & procedures can be found on the Department's website by visiting <https://www.dornrc.com/collect/information.html>

9. The e-Services portal still does not support an up-to-date version of internet explorer (IE). IE9 is the most current version that works on e-Services. Microsoft stopped supporting IE9 some time ago. The current version of IE is IE11 and NCDR e-Services will not work with this version. What would it take to get NCDR upgraded to work with IE11?

A Request for Proposal has been released to acquire a vendor to begin updating the online file and pay services. Updates to online file and pay services will occur in phases.

10. Practitioners continue to ask when NCDR will have online services available to practitioners similar to the IRS e-Services system. What assistance can NCACPA provide to help obtain funding for such a project?

As online file and pay services are updated, features will be evaluated with the objective of enhancing services if possible.

11. A number of practitioners have been frustrated by the NCDR website. Some of the materials are out of date and the search feature often does not return the results expected. For example, if you enter Form CD-400 MS in the search box, nothing populates, even though the form is still available on the website. Are there any plans to focus more resources on making the website more user friendly and refreshing outdated material?

The website has been redesigned and is scheduled for release in December. The new site has a simplified navigation which allows easier, more direct access to complete transactions and find information. The new site is optimized for mobile devices and is browser neutral. The search capability is significantly improved and will incorporate keywords and phrases from every page and document on the site.

14. What is the NCDR policy (or statute, if applicable) regarding communication to the IRS of NCDR income tax audit results? Are there differing policies for personal versus business income tax audits?

North Carolina Department of Revenue and the Internal Revenue Service have a specific Implementing Agreement which governs the exchange of data between the two Agencies. The contents of the agreement nor any exchange criteria cannot be disclosed per IRC 6103.