

Questions for Discussion with NC Department of Revenue Thursday, December 13, 2018

Submitted by the NCACPA Taxation Committee and the Tax Section of the NC Bar Association

Individual Income Tax Issues

1. What PDF attachments to e-filed returns does NCDoR request (for example, Bailey retirement information, credit for foreign taxes paid on dividends as reported by brokerage firm, etc.)?

The Department requests the same attachments to an e-filed return as it does to a paper-filed return. There is no distinction. For example, an individual taxpayer should attach the following forms to an e-filed D-400:

- Form NC K-1 (if a taxpayer claims a tax payment from an S-Corporation or partnership)
- Another state or country's tax return (if a taxpayer claims a credit for income tax paid to another state or country)
- 2. A number of practitioners have received copies of NCDoR notices from their clients asking that all W-2s and 1099s for the tax year be submitted. What is prompting these notices? Is there something practitioners should be doing differently to avoid the extra time and expense these notices generate?

The Department identifies cases, within our refund fraud and identity theft program, where data sources within the Department do not reconcile with taxpayer return information. The Department requests additional documentation directly from the taxpayer to ensure the return is not fraudulent or the taxpayer's identity has not been stolen. The volume of these requests were significantly up this past filing season. The Department has analyzed the process and believes the number of these requests should be reduced for the 2019 filing season.

3. There are instances where a taxpayer may not have a copy of their W2 and are unable to obtain one, for instance if the employer has gone out of business. We have discussed in the past NCDoR's inability to provide a transcript of this information, and the IRS transcripts do not contain state info. The NCDoR communicated to NCACPA in June that this may be fixed in the future with new technology. What is the status of this? Along the same lines, a CPA this year was told by a NCDoR agent on the phone that NCDR does in fact have the withholding information but will not share it with CPAs. Is this true? If a



taxpayer only had \$500 withheld but claimed a different amount on his tax return, would NCDoR know the true withholding figure and refund the correct amount? Is there any potential for NCDoR to have a transcript service available where practitioners could obtain this information with a POA?

NC-3s and corresponding W-2s and 1099s are required to be filed by January 31, electronically, and in a specifically prescribed format. To ensure the Department's adherence to State Tax Information and protect taxpayer's from potential identity theft, the Department is currently compiling our policy and procedure to provide taxpayers with this information upon their request. Once the procedures are finalized and training of our staff is complete, the Department will roll out the service. We hope to have this service in place within the first quarter of 2019.

I understand the second part of the question may originate from our non-filer program. The Department does identify taxpayers that fail to file a North Carolina individual income tax return and subsequently sends a letter requesting the taxpayer file a tax return. If the taxpayer fails to comply with our request, an assessment is issued to the taxpayer based on the best information available to the Department. The taxpayer is given credit for any income tax withholding identified within our records when calculating the tax liability.

4. This is an ongoing issue impacting our members. It revolves around an IRS tax return that is amended and Adjusted Gross Income changes. When the IRS accepts an amended return, the AGI referenced on the Account Transcript remains unchanged (i.e. original AGI prior to amended return being filed remains). Instead, notes are entered on the Account Transcript reflecting the submission and acceptance (if accepted) of the taxpayer's amended return. If the taxpayer also amends the NC return, NCDoR's policy is to not accept taxpayer's amended return until IRS accepts the return including AGI being changed to reflect the amended AGI (see Attachment 2). It appears that NCDoR does not accept amended returns until IRS has accepted them, even though the taxpayer provides the complete IRS amended return to NCDoR with supporting schedules. This issue was not resolved until finally the NCDoR Taxpayer Advocate, after much back and forth, finally accepted the AGI change. This matter should not require so much time as the client is forced to pay professional fees to get it resolved, and apparently this has occurred throughout several years.

The Examination Division reviews all amended returns filed with the Department, which averages approximately 64,000 amended returns each year. It is the Department's policy and procedure to accept all amended returns filed with the Department and then assign to an auditor for review and processing. To expedite the processing of an amended return, all supporting documents, forms, and schedules should be attached with a clear explanation of the changes. An auditor may request additional information



needed to support items on the return including a change in adjusted gross income. Once the auditor finalizes their review of the documentation, the amended will be processed within ITAS. It is not our policy or procedure to hold any amended return until the IRS accepts the amended return with the potential exception of an amended return that would modify an IRS audit.

We understand there has been some miscommunication from our auditors indicating we require an IRS transcript on all amended returns. We are providing additional training to staff to ensure proper policy and procedures are followed and only the necessary supporting documentation is requested if not attached to the amended return. It is our goal to expedite the processing of the amended return. If you continue to have issues, please contact Alan Woodard at 919-675-5892 so he may address the issue.

5. The NC online payment system for personal taxes drafts funds the following day. So, any clients that are trying to pay online today, rather than postmarking a check, will have the funds drafted tomorrow.

The effective (or draft) date of the online payment is the date credited to the tax account. When an online payment is submitted on the due date via NCDOR.gov, it is considered timely—even though the payment is not drafted or funds received until the next day.

Does NC credit the payment on the date it is initiated (today) rather than drafted (tomorrow)? If not, why? The state still gets its money faster than if they postmarked a mailed check today. IRS allows you to draft on the same day, so the issue is isolated to NC. This, of course, mainly affects returns being filed on the due date.

Same-day ACH online payment is not currently available with NCDOR. We have raised this payment option for future consideration by the entities that are a part of and administer the state EFT contract.

Business Income Tax Issues

1. On February 8, 2018, NCDoR issued a notice from the Personal Taxes Division on the NC-3 and 1099 filing requirements. What changes to those stated policies can we expect for 2018 returns to be filed in January 2019?

The 2018 General Assembly amended G.S. 105-236(a)(10) as part of a series of changes to the State's informational return statutes to impose specific penalties with regard to certain informational returns. As enacted, the penalties apply to informational returns required by Article 4A (Withholding Tax).

Specifically, sub-subdivision (c) of G.S. 105-236(a) (10) was amended to modify the existing penalty for failure to file an informational return. As amended and specifically stated in G.S. 105-236(a) (10) (c), the Secretary shall assess a penalty of fifty dollars



(\$50.00) per day, up to a maximum penalty of one thousand dollars (\$1,000) against a taxpayer that fails to file an informational return by the date the informational return is due. In addition, new sub-subdivision (d) was added to create a new informational return penalty. As enacted, G.S. 105-236(a)(10)(d) imposes a penalty of two hundred dollars (\$200) against a taxpayer that fails to file an informational return in the format prescribed by the Secretary. Since the effective date of this legislation was June 12, 2018, these penalties affect NC-3 forms due to be filed on or before January 31, 2019.

Importantly, the Secretary does not intend to automatically waive informational return penalties assessed on NC-3 forms due to be filed by January 31, 2019, but which are filed after that date and/or are not filed in accordance with the requirements of the Secretary. A taxpayer may request a waiver of an informational return penalty by filing new Form NC-5501, Request for Waiver of an Informational Return Penalty. An informational return penalty waiver request will not affect the taxpayer's good compliance record for filing tax returns. Form NC-5501 will be available on the DOR website early January 2019.

2. How will NCDoR handle partnership examinations now that the new federal rules are in place allowing assessment at the partnership level versus adjustment and assessment of each individual partner?

Unless and until the North Carolina General Assembly modifies North Carolina tax law, the Department will continue its current examination practices in regards to partnerships and individual partners.

Sales and Use Tax Issues

1. Request for clarification of the taxation of tangible property transactions in NC and other states by a NC company.

Background

The taxpayer is a NC corporation located in NC. The taxpayer's primary business is to purchase steel for the fabrication and ultimate erection of a building's structural steel framing during the initial construction of a building. The taxpayer's contract is generally a lump sum contract with a licensed general contractor, however can be a lump sum contract with the property owner. The contract generally is for the fabrication and ultimate erection of the structural steel at a lump sum price with the customer. The taxpayer purchases steel and steel components and fabricates and assembles part of the structural steel at the taxpayer's facility, generally based on plans and specifications provided by the customer. The structural steel components are then transported to construction site locations that are in various counties in NC and at times at locations outside of NC in states in the Southeast.



At times, the taxpayer will sell structural steel components fabricated by the taxpayer at the taxpayer's facility to customers in NC.

Questions:

1. Is the contract between the taxpayer and the general contractor or property owner, a real property contract and exempt from NC sales tax on the contract amount?

A real property contractor is a "person that contracts to perform a real property contract in accordance with G.S. 105-164.4H. The term includes a general contractor, a subcontractor, or a builder for purposes of this Article."

A real property contract is a "contract between a real property contractor and another person to perform a capital improvement to real property."

A retailer-contractor is a "person that acts as a retailer when it makes a sale at retail and as a real property contractor when it performs a real property contract."

Based on the facts included herein, it appears the taxpayer is a retailercontractor that is not registered for sales and use tax purposes. When the taxpayer purchases steel and steel components from a North Carolina supplier which it fabricates, assembles, and transports to a construction site in North Carolina and the taxpayer erects the fabricated steel to create a building's structural steel framing, the taxpayer is operating as a real property contractor. New construction, reconstruction, and remodeling are considered capital improvements and are exempt from sales and use tax if the taxpayer maintains documentation to substantiate the real property contract is a real property contract with respect to a capital improvement.

Sales tax is due on the purchase price of any tangible personal property, digital property, or services used to fulfill a real property contract in North Carolina and should be paid to the North Carolina supplier. If the steel and steel components are purchased from an out-of-state supplier, the taxpayer is liable for remitting the use tax directly to the Department if the out-of-state supplier fails to collect and remit the tax. Because the fabricated steel and steel components become a part of real property in North Carolina, the real property contractor, the retailer-contractor, the subcontractor, the lessee, and the owner of the building are jointly and severally liable for the tax. The liability of the real property contractor, the retailer-contractor, the retailer-contractor, the subcontractor, the subcontractor, the subcontractor of the building who did not purchase the steel and steel components is satisfied upon receipt of an affidavit from the purchaser certifying the tax has been paid.

When the taxpayer fabricates and sells structural steel components, the taxpayer should collect and remit sales tax to the Department on the sales price of the fabricated steel sourced to North Carolina without any deduction for labor. If the taxpayer is not registered to collect and remit sales and use tax, the taxpayer should register with the Department by completing and submitting the



NC-BR on the Department's webpage or by printing, completing, and mailing the NC-BR to the Department.

If the taxpayer paid sales tax on the raw material steel when it was purchased, the taxpayer will be able to recover the sales tax paid on the purchase of the raw material steel. When filing its sales and use tax return, the taxpayer may reduce taxable receipts by the taxable amount of the purchase price of the raw material steel for the period in which the retail sale is made.

2. The taxpayer purchases steel from a steel products company outside the State of NC for the purpose of fabricating and ultimate erection of structural steel components in the performance of a lump sum contract for the construction of a building. The steel manufacturer delivers the steel to the taxpayer's facility in NC. No tax is charged to the taxpayer by the steel company. Does the NC taxpayer calculate NC sales and use tax on the purchase and remit to NC?

Yes, the NC taxpayer is liable for tax on its purchases of steel that will become part of real property in North Carolina. The tax is due to be remitted to the Department on or before the 20th day of the month following the month in which the taxpayer received the steel if the taxpayer is filing sales and use tax returns on a monthly basis. If the taxpayer is filing sales and use tax returns on a quarterly basis, the tax is due to be remitted to the Department on or before the last day of the month following the calendar quarter.

3. The taxpayer purchases steel from a steel products company within the State of NC for the purpose of fabricating and ultimate erection of structural steel components in the performance of a lump sum contract for the construction of a building. The steel manufacturer delivers the steel to the taxpayer's facility in NC. No tax is charged to the taxpayer by the steel company. Does the NC taxpayer calculate NC sales and use tax on the purchase and remit to NC?

Yes, the NC taxpayer is liable for tax on its purchases of steel that will become part of real property in North Carolina. The tax is due to be remitted

to the Department on or before the 20th day of the month following the month in which the taxpayer received the steel if the taxpayer is filing sales and use tax returns on a monthly basis. If the taxpayer is filing sales and use tax returns on a quarterly basis, the tax is due to be remitted to the Department on or before the last day of the month following the calendar quarter.

4. The taxpayer purchases steel and components from a steel products company that are generic in nature and that will ultimately be used to complete lump sum contracts for the fabrication and ultimate erection of structural steel for the construction of a building in NC. No tax is charged to the taxpayer by the steel



company. Does the NC taxpayer calculate NC sales and use tax on the purchase and remit to NC at the time of the purchase from the steel products company?

Yes, the NC taxpayer is liable for tax on its purchases of steel and components that will become part of real property in North Carolina. The tax is due to be remitted to the Department on or before the 20th day of the month following the month in which the taxpayer received the tangible personal property if the taxpayer is filing sales and use tax returns on a monthly basis. If the taxpayer is filing sales and use tax returns on a quarterly basis, the tax is due to be remitted to the Department on or before the last day of the month following the quarter.

5. The taxpayer sells structural steel components fabricated by the taxpayer at the taxpayer's facility to customers in NC, to be assembled and erected in the construction of a building by the customer or the customer's contactor. Does the taxpayer charge sales tax on the sales price of the fabricated steel components to the customer? If tax is to be charged on the selling price of the item to the customer and sales and use tax was paid on the steel purchased by the taxpayer when the raw material steel was purchased, does the taxpayer reduce the sales tax remitted on the item for tax paid on raw materials?

Yes, the taxpayer should charge sales tax on the sales price of the fabricated structural steel components without any deduction for labor. If the taxpayer paid sales tax on the raw material steel when it was purchased, the taxpayer will be able to recover the sales tax paid on the purchase of the raw material steel.

When filing its sales and use tax return, the taxpayer may reduce taxable receipts by the taxable amount of the purchase price of the raw material steel for the period in which the retail sale is made.

2. The online Sales and Use Tax Technical Bulletins contain a message in red indicating the bulletins have not been updated for 2009-2018 law changes. There is a convenient link to the Legislative Changes for each year but it is very difficult and time consuming to review all the law changes for so many years to determine what has been changed. Is there any plan to get the Bulletins updated so they are more user friendly?

Yes, our goal is to have Sales and Use Tax Bulletins published in January 2019.

3. NCDoR issued SD-18-6 on August 7, 2018, after the South Dakota v. Wayfair decision was handed down. Are there any modifications or further interpretations to this directive that we should share with our membership?

The Sales and Use Tax Division created and posted Frequently Asked Questions regarding remote sales on the Department's website on August 31, 2018. If and



when the General Assembly makes changes to the General Statutes regarding remote sales, the Department will communicate any changes to taxpayers.

Other Questions and Issues

1. What is the effective date for NC to begin accepting the federal extension in lieu of filing an extension with NCDoR? What returns will be covered by filing a federal extension only?

The effective date for Session Law 2018-5 as enacted by the General Assembly is for taxable years beginning on or after January 1, 2019.

As prescribed by the General Assembly, a person who is granted an automatic extension to file a <u>federal income</u> tax return, including a return of partnership income, is granted an automatic extension to file the corresponding State income tax return and franchise tax return. Those returns include: (1) individual income tax returns (Form D- 400), (2) partnership income tax return (Form D-403), (3) estates and trusts (Form D- 407), (4) C corporation tax return (Form CD-405), and (5) S corporation tax return (Form CD-401S).

2. What is the process for a practitioner to obtain an authoritative, written response to a specific question submitted? Is the process the same for individual taxes, business taxes, sales and use taxes, etc.?

To obtain an authoritative, written response to a specific question, a taxpayer should request a written determination in accordance to the Department's "<u>Written Determination Policy</u>." The policy can be obtained from the Department's website.

3. From a practitioner: We had a client—a C Corporation—that was due to receive a refund from NC for the 2017 tax year. When the refund came, it was for much less than the amount that we were expecting. I obtained a POA and called NCDoR and discovered that one of our client's two estimated tax payments (both clearly marked as estimated tax payments on the checks), had been applied to their 2016 franchise tax, which had already been paid. The 2016 franchise tax credit was just sitting as a credit on the account. When I asked the agent with whom I spoke what would have been done about the credit had I not called and asked about it, he only said that it probably would have been worked out eventually. The response did not instill a lot of confidence in me that it would have been handled correctly at all. What is the process and timeframe for NCDoR to review credit balances in accounts?

To determine the root cause of why one of the estimated tax payments presented in your example was applied to 2016 tax year instead of 2017 tax year, we would like to have the specific taxpayer information to review and ensure we improve our



process. However, when a return is filed and that specific tax schedule and tax year is out of balance, our system of record, ITAS, creates a review item. The Department's review item team manually works each review item generated from ITAS to reconcile the account. Most review items can be completed without additional contact from taxpayers; however, there are review items that may require additional documentation from the taxpayer to complete.

4. When do you expect to have e-filing capability for fiduciary income tax returns?

The Department is currently planning to implement e-file for fiduciary income tax returns in 2022, for filing 2021 tax year returns.

5. Are there any directives or other pronouncements in process to be issued pertinent to the 2018 filing year that we should be looking out for?

From a Personal Taxes perspective, the following important notices that affect tax year 2018 have been previously published:

- 1. "<u>North Carolina's Reference to the Internal Revenue Code Updated Impact on</u> 2017 and 2018 North Carolina Corporate and Individual Tax Returns" dated August 21, 2018.
- 2. "<u>Tax Credits Involving Partnerships</u>" dated September 10, 2018.
- 3. "Important Tax Law Changes For Employers, Pension Payers, And Others That Withhold North Carolina Income Tax" dated October 27, 2018.
- 4. The Department has also published several <u>Important Notices</u> regarding areas impacted by Hurricane Florence.

The important notices can be obtained from the Department's website. These notices also affect corporate taxpayers as well.