

NOVEMBER 2024

**2024 NCACPA NORTH CAROLINA STATE
TAX UPDATE**

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2

OVERVIEW OF TODAY'S DISCUSSION

- I. North Carolina Personal Income Tax Changes
- II. Remote Workers: Concerns for Employers and Employees
- III. NC Sales and Use Tax Changes and Cases



3

OVERVIEW OF TODAY'S DISCUSSION (Cont'd)

IV. Corporate Income and Franchise Taxes

V. NC Tax Administration

VI. Recent Office of Administrative Hearing Decisions

VII. Recent NCDOR Private Letter Rulings



PART ONE
PERSONAL INCOME TAX DEVELOPMENTS

PAGE 6

I. New Increased Standard Deduction Amounts.

	<u>2024</u>	<u>2023</u>
<u>Filing Status</u>	<u>Standard Deduction Amounts</u>	<u>Standard Deduction Amounts</u>
Single	\$14,600	\$13,850
Married filing separately and surviving spouse	\$14,600	\$13,850
Married filing jointly	\$29,200	\$27,700
Head of Household	\$21,900	\$20,800

PART ONE
PERSONAL INCOME TAX DEVELOPMENTS

PAGE 6

II. New Individual Tax Rates.

HB 259 (2023) reduced the flat individual tax rates from 4.99% as follows:

<u>Tax Year</u>	<u>Tax Rate</u>
2022	4.99%
2023	4.75%
2024	4.5%
2025	4.25%
2026	3.99%
Years after 2026	?

PART ONE
PERSONAL INCOME TAX DEVELOPMENTS
PAGE 7

After 2026, if North Carolina's General Fund Revenue targets are met, then the personal income tax rate for the subsequent year will lower by one-half of a point if revenue hits the trigger amount each year, with 2.49% being the lowest rate, but no sooner than 2029.

<u>Fiscal Year</u>	<u>Trigger Amount</u>	<u>Beginning in Taxable Year</u>	<u>Rate</u>
2025-26	\$ 33 BN	2027	3.49
2026-27	\$ 34.1 BN	2028	3.49
2027-28	\$ 34.76 BN	2029	2.49
2028-29	\$ 35.75 BN	2030	
2029-30	\$ 36.5 BN	2031	

NOTE: 2022-23 Fiscal Year Revenue was \$33.535 Billion.
2023-24 Fiscal Year Revenue was \$33.69 Billion.

PART ONE
PERSONAL INCOME TAX DEVELOPMENTS

PAGE 7

Employer Income Tax Withholdings. Note that, under N.C.G.S. 105-163.2(b)(1), the withholding rates on wages are the rates scheduled above **plus** .1%.

PART ONE
PERSONAL INCOME TAX DEVELOPMENTS

PAGE 7

III. Real Property Conservation Credit Reintroduced.

- 25% of FMV of donated conservation property.
- Capped at \$200,000 for individuals and \$500,000 for Corporations.
- Limited to \$5 Million in total each year for all applicants.
- Credit Only for 2025 and 2026.

PART ONE
PERSONAL INCOME TAX DEVELOPMENTS

PAGE 10

IV. North Carolina Reduces the Late Payment Penalty

General Rule: Late payment penalty equal to ten (10%) percent of the net tax underpayment.

New Rule: Session Law 2021-180 change from current 10% flat rate to a graduated rate.

Originally would be effective for taxes assessed on or after July 1, 2022.

A decorative image of a wooden floor with vertical planks, located at the bottom of the slide.

PART ONE
PERSONAL INCOME TAX DEVELOPMENTS

PAGE 10

IV. North Carolina Temporarily Reduces the Late Payment Penalty

NCDOR existing software could not accommodate this quick change.





IV. North Carolina Temporarily Reduces the Late Payment Penalty

Session Law 2022-13 (June 29, 2022):

- Continued the penalty rate of ten percent (10%) through December 2022
- Then, temporarily reduced the penalty rate to five percent (5%) from January 2023 to June 2024.
- Then, beginning in July 2024, a graduated penalty rate of 2% per month until the tax is paid, up to a maximum penalty of 10%.



- Postponed Effective Dates
 - - 5% per month (25% maximum) until June 2027.
 - - Then 2% per month (10% maximum).

PART TWO
**SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE
OR WORK REMOTELY AND FOR THEIR EMPLOYERS**

PAGE 26

I. Introduction: Covid Starts the Migration.

- Many employers sent their workers home and many of those employees elected to move to another state during the Covid pandemic.
- Employees discovered that they could work effectively and efficiently through a home office outside of their employer's state.

Have these employees gone back to their employer's business state or do they to continue to work remotely?



PART TWO
**SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE
OR WORK REMOTELY AND FOR THEIR EMPLOYERS**

II. Concerns for the Employer.

A. Nexus Implications for Telecommuting Employees:

Telecommunicating activities can create “Nexus” in new states.

Public Law 86-272 prohibits states from assessing income tax on a company where the only activity of that company is soliciting out of state sales for the purchase of tangible property

PL 86-272 does not protect employers who have employees located in another state.



SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

II. Concerns for the Employer.

A. Nexus Implications for Telecommuting Employees:

Likewise, the protections under the U.S. Supreme Court of Wayfair may not provide any relief for the employer.

SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

Concerns for the Employer.

A. Nexus Implications for Telecommuting Employees:

For example, assume that an employer is not collecting and remitting sales tax in state “X” based upon the Wayfair matrix of less than 200 transactions during the year or less than \$100,000 of sales in that state during the year.

However, this is merely “**the economic presence**” nexus test as approved by the US Supreme Court in Wayfair and does not have any bearing on the “**physical presence**” nexus test.

SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

II. Concerns for the Employer.

B. Income Tax Withholding Obligations.

Employer must withhold for the State where the employee is “sitting”.

- Employer liability for failure to withhold
- Employer must ascertain employees’ work locations

SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

II. Concerns for the Employer.

C. Workers Compensation and Unemployment Tax Issues



SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

PAGE 27

III. Concerns for the Employee.

A. **Overview:** For remote employees that work from home for an out of state employer, there are **different sets of rules** that may apply:

- Some states do not assess income taxes on employees that work out of state from home.
- Some states provide a tax credit for taxes paid on income earned in another state.

SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

II. Concerns for the Employee.

B. Withholding Rules for Telecommuting Employees: Generally, most states have determined that the employee's physical presence dictates where the tax is due.

This means that if an employee is working in North Carolina for an out of state employer, then the typical rule is that North Carolina gets the income tax withholding.



2 | SPECIAL STATE TAX ISSUES FOR EMPLOYEES WHO TELECOMMUTE OR WORK REMOTELY AND FOR THEIR EMPLOYERS

III. Concerns for the Employee

C. The “Domicile Rule” and the “183-Day Per Year Rule”: Some states have a “domicile rule” as well as a “183-day per year” rule.

Remember, “**domicile**” is only changed when a person abandons the original state of domicile and then adopts another state as the new state of domicile.

For example, in New York, if you are deemed **domiciled** in New York, then New York taxes all of the New York resident’s worldwide income.



C. The “Domicile Rule” and the “183-Day Per Year Rule”:

In addition, other states (such as New York and Connecticut) **also** apply a “**183-day**” rule for nonresidents.

In these states that impose the “183-day” rule to nonresidents, a nonresident is subject to that state’s income tax on worldwide income if the taxpayer merely resides 183 days in that state, even if that person is domiciled in another state.

- Some States do not recognize the 183-day residency rule of other states.
- Possible Double State Taxation.



23 D. The Convenience of the Employer Rule: Also, other states, other than North Carolina, impose something called the “**convenience of the employer**” rule (Arkansas, Delaware, Nebraska, New York and Pennsylvania).

Under the “convenience of the employer” rule, if the **employer** is located in one of those states, then the tax withholding obligations may have to be paid as if the work was performed in the employer’s location **regardless** of where the employee is located when the employee provides those services.



D. The Convenience of the Employer Test.

So, for example, an employee working for a business in New York who decides to work remotely out of their vacation condo in Florida, would be subject to New York tax on all wages earned by that person by virtue of the fact that he/she is working in Florida merely for his/her own convenience.

May result in **double taxation** in states that don't recognize "**convenience rule**" of other states.



III. Concerns for the Employee.

D. The Convenience of the Employer Test.

Note, there may be certain circumstances where business necessity or business purpose can defeat the “Convenience” rule.

For example, in the example above, if the taxpayer had to work remotely in Florida to call on sales customers of the New York company, then the New York State taxing authorities may not be able to reach the wage income earned by that individual working out of Florida because of business necessity or business purpose rule.



The “Alabama” Rule

Page 27

Nonresidents working for employer in Alabama are “doing business” in Alabama.

Bollinger, Alabama Tax Tribunal (March 8, 2023)

Baty, Alabama tax Tribunal (May 19, 2023)

- **Workers “abandoned” Alabama and adopted new state of domicile.**
- **But, kept working out-of-state for Alabama employer.**



The “Alabama” Rule

Page 27

- **Alabama Tax Tribunal Says**
 - Form W-2 income is “Alabama Sourced” income from “doing business” in Alabama
 - Even though services are provided Out-of-State

Page 28

NOTE: N.C.G.S. 105-153.8(2), 105-153.2(2) and 105-153.4(b) impose NC tax on non-resident income from an “**occupation carried on**” in North Carolina.

PART THREE

PAGE 38

SALES TAX CHANGES

I. Changes to NC “Economic Nexus” Threshold.

- The U.S. Supreme Court’s Decision in Wayfair and the New “Economic Presence” Nexus Test for Sales Taxes for Out-of-State Remote Sellers

Overview of Wayfair. June 21, 2018, U. S. Supreme Court upheld the constitutionality of a South Dakota nexus statute which required that out-of-state remote sellers collect sales tax if it

- (1) made more than \$100,000 in sales into the state of South Dakota or
- (2) engaged in at least 200 sales transactions with South Dakota residents,
- regardless of whether or not the remote seller actually had any physical presence in South Dakota and even if it had no assets or employees physically present in the State of South Dakota.

[South Dakota vs. Wayfair, Inc., 138 S. Ct. 2080 (2018)].

- In Wayfair, the Supreme Court overruled its earlier 1992 decision in Quill vs. North Dakota that established the “physical presence” requirement that required states to show that remote sellers have a physical presence in that state before for states could force the out-of-state retailers to collect sales tax.
- ▶ Wayfair now substitutes an “economic presence” test for the “physical presence” nexus test previously in place under the Quill decision.

- By now, most states have enacted economic presence legislation very similar to the South Dakota legislation that was the subject of the Wayfair case.

- **In 2018, North Carolina Adopted The Economic Nexus Test For Remote Sellers.** Remote out-of-state sellers:
 - having gross sales in excess of \$100,000 sourced in North Carolina
 - or two hundred (200) or more separate transactions sourced in North Carolina
 - in the previous or current year
 - must register, collect and remit sales and use tax

- Beginning November 1, 2018 or 60 days after the seller meets the threshold amount, whichever is later

- 2024: NC Drops the “200 transaction” Threshold.
 - Effective July 1, 2024

PART THREE

Sales and Use Tax Developments

II. New Statute of Limitations on Assessment of Refunded Sales Taxes.

Under House Bill 228 (SL 2024-28), if a retailer collects a sales tax on a transaction and later refunds that sales tax to the purchaser, the NCDOR may now assess the sales tax to the purchaser within three years of the date of the refund. N.C.G.S. 105-241.8(b)(5).



PART THREE

NORTH CAROLINA SALES AND USE TAX DEVELOPMENTS – PAGE 41

III. New Time Limits on Obtaining Affidavit of Capital Improvement

**Background: HB 97 (2015) Expanded the Sales Tax Base To
Include Repair, Maintenance and Installation Services**

See new Section 105-164.3(33d).

PART FOUR

NORTH CAROLINA SALES AND USE TAX DEVELOPMENTS – PAGE 41

Sales/Use Tax Rules for “Real Property Contractors”

Effective January 1, 2015, real property contractors became responsible for paying sales & use tax on purchases of personal property used to:

- Build real property
- Improve real property

New N.C.G.S. 105-164.4(a)(13)

PART THREE

NORTH CAROLINA SALES AND USE TAX DEVELOPMENTS

But, no sales tax assessed on “capital improvements” to real property.

So, taxpayers need to get Affidavit of Capital Improvement.



III. New Time Limits For Obtaining an Affidavit of Capital Improvement.

House Bill 228 (S.L. 2024-28) now provides that, to substantiate the exemption from collecting sales tax on capital improvements to real property, a service provider must obtain the Affidavit of Capital Improvement within 90 days of the service sale or within 120 days of a request by the NCDOR. S.L. 2024-28, Sec. 2.5; N.C.G.S. 105-164.4H(a1).

This change is effective July 1, 2024.



IV. NCDOR Issues “Important Notice” For Real Property Contractors to Certify Payment of Sales and Use Tax; August 5, 2024.

- A. Background.** Under N.C.G.S. 105-164.4H(a), a real property subcontractor normally must pay sales and use tax on the sales price of materials it purchases to perform a real property contract.

IV. NCDOR Issues “Important Notice” For Real Property Contractors to Certify Payment of Sales and Use Tax; August 5, 2024.

For example, if a general contractor hires a subcontractor to purchase and install cabinets in a new home, the subcontractor must pay sales and use tax on the sales price of cabinets and hardware it purchases to perform the real property contract for the homebuilder.



IV. NCDOR Issues “Important Notice” For Real Property Contractors to Certify Payment of Sales and Use Tax; August 5, 2024.

Importantly, under N.C.G.S. 105-164.6(b), if the subcontractor (the cabinet installer in our case) fails to pay sales tax on its hardware and cabinet purchases, then the following people are jointly and severally liable for sales tax the cabinet installer failed to pay:

- the real property owner;
- the lessee;
- the real property contractor; and
- the subcontractor.



B. New Form E589P, Affidavit of Tax Paid by Real Property Contractor.

On August 5, 2024, the NCDOR issued a new **Important Notice** which now makes available a new affidavit, Form E589P, Affidavit of Tax Paid by Real Property Contractor.

The purpose of this new form is to provide real property contractors and property owners with an affidavit it may rely upon to substantiate that a contractor has paid sales and use tax on the materials it purchases and affixes to real property as part of the real property contract.



B. New Form E589P, Affidavit of Tax Paid by Real Property Contractor.

The Important Notice also provides a “comparison and contrast” analysis of the differences between Form E589P and Form E589CI, Affidavit of Capital Improvement, and when those forms are used during the course of a real property contract.



V. Quad Graphics – North Carolina Supreme Court, April 12, 2023

Destination Based Sales Tax Sourcing Rule Not Unconstitutional, Even Though Title Passes Outside of North Carolina.

PART THREE

Sales and Use Tax Developments

PAGE 42

North Carolina Sales Tax “Destination Based Sourcing” Statute Not Unconstitutional

N.C.G.S. 105-164.4B(a)(2)

- 2007 to 2011 tax years
- Wisconsin Corp sells books, magazines and catalogues to customers in North Carolina

PART THREE
Sales and Use Tax Developments

PAGE 42

- No physical facilities in North Carolina
- But, in September 2009, sales agent becomes employed in North Carolina to solicit sales and to service customers
- All products shipped into North Carolina via common carrier
- Shipping “FOB Shipping Point” so title and risk of loss passes to customers outside of North Carolina



PART THREE
Sales and Use Tax Developments
PAGE 42

Relevant North Carolina Statute:

- When purchaser receives product at location specified by purchaser inside North Carolina, sale is “sourced” to North Carolina.

North Carolina Supreme Court:

- Quad Graphics becomes responsible for collecting and remitting sales tax to North Carolina starting in September 2009 when Sales Agent became employed in North Carolina.
- North Carolina Destination Sourcing Sales Tax Statute not unconstitutional

Sales and Use Tax Developments

PAGE 43

VI. NCDOR vs. FSC

- North Carolina Business Court
- January 30, 2023
- Mill Machinery Exception Available Even Though 80% of Product Used by Taxpayer/Manufacturer and Not For Retail Sale

Sales and Use Tax Developments**PAGE 42**

- FSC is a road construction company.
- FSC produced hot mix asphalt (HMA) for its own use and for sale to competitors.
 - 80% for its own use
 - 20% for sale to competitors

NCDOR vs. FSC

- FSC Says it is a “manufacturer” and thus tools and equipment purchased out of state to manufacture HMA was exempt “mill machinery”.
- NCDOR says FSC was “primarily engaged” in road construction and not “manufacturing” products for sale to third-party customers.



Business Court Rules in Favor of FSC because it was a “manufacturer” operating a “manufacturing industry or plant”

- Producing HMA was consistent with generic definition of “manufacturing”.
- NCGS 105-187.1 does not require that taxpayer be engaged “primarily” or “principally” in business of manufacturing product for sale to third parties.
- Sale of 20% of HMA to competitors was not “insignificant”.

PART FOUR

54

Corporate Income and Franchise Tax Developments

PAGE 47

I. Corporate Income Tax Reductions.

<u>Tax Year</u>	<u>Tax Rate</u>
2023	2.5%
2024	2.5%
2025	2.5%
2026	2%
2027	2%
2028	1%
2029	1%
2030	0%

PART FOUR

55

Corporate Income and Franchise Tax Developments

PAGE 47

II. Franchise Tax Changes.

Before 2023, the North Carolina corporate franchise tax was determined based on the greater of the following three factors: (1) the corporation's "net worth" as determined under GAAP; (2) the "book value" of its North Carolina real and tangible personal property (minus any debt on the real property); and (3) 55% of the corporation's "appraised value" of its North Carolina real and tangible personal property.

Under Senate Bill 105, going forward, the North Carolina franchise tax will be determined solely based upon the corporation's "net worth" as determined under GAAP.

This change is effective for franchise taxes due for 2023 as reported on the 2022 corporate income tax return.

PART FOUR

56

Corporate Income and Franchise Tax Developments

PAGE 47

William Nelson at Smith Anderson in Raleigh

- Old version of NC Franchise Tax Statute may violate “internal consistency” test of US Commerce clause.
- May be unconstitutional.
- Tennessee allows refund claims.
- NC Taxpayers may wish to file NC franchise tax refund request for 2022 franchise tax reported on 2021 returns.
- Must file refund claim by April 15, 2025.

PART FIVE

57

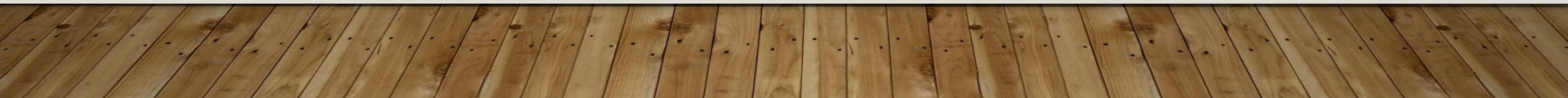
Corporate Income and Franchise Tax Developments

PAGE 48

II. House Bill 259 (Session Law 2023-134) Caps the Franchise Tax.

House Bill 259 (October 3, 2023) caps the franchise tax rate at \$500 for the first \$1 Million of a C corporation's tax base. After that, the existing rate of \$1.50 per \$1,000 of its tax base applies up to a **maximum tax due of \$150,000.**

This change becomes effective on January 1, 2025, and applies to the franchise tax calculation on the 2024 corporate income tax return.



PART FOUR
Corporate Income and Franchise
Tax Developments
PAGE 48

III. The Reintroduction of Real Property Conservation Credit.

Senate Bill 355 (S.L. 2024-32) has resurrected the real property conservation credit for two (2) years. The amount of the credit is equal to **25% of the fair market of value real property** located in North Carolina and donated for conservation purposes. The amount of the credit is capped at **\$500,000 for corporations.**

Also, the maximum amount of credits allowed in a year to all qualifying taxpayers is limited to \$5 million, which means that the credits will be prorated for credit applications that exceed \$5 million in total.

- 2025 and 2026 only.

PART FIVE
North Carolina Procedure
Page 66

I. NCDOR Issues “Important Notice” Power of Attorney Form Updated to Authorize Representatives to Receive Copies of Available Notices; August 20, 2024.

The NCDOR has announced it is updating its systems to send copies of NCDOR notices to authorized representatives. Once this update is complete, the NCDOR will start sending notices to the authorized representatives. The NCDOR expects to start sending notices to authorized representatives **in early 2025**.

PART FIVE
North Carolina Procedure
Page 66

I. NCDOR Issues “Important Notice” Power of Attorney Form Updated to Authorize Representatives to Receive Copies of Available Notices; August 20, 2024.

To make sure the authorized representative will start receiving copies of NCDOR Notices sent to the taxpayer, the taxpayer must submit **new POA (even if you already have one on file)** which includes the following information:

- Email address for authorized representatives;
- Tax periods covered by NCDOR notices to be sent out; and
- The taxpayer **must “check the new box”** on Form Gen-58 (located at the bottom right corner of the block for designated representative’s name and contact information).



PART FIVE

North Carolina Procedure

Note: The NCDOR will only send copies of certain notices. To see types of notices of which the NCDOR will be sending copies to the authorized representative, see the NCDOR website.

PART FIVE
North Carolina Procedure
Page 68

II. Don't Forget About Withholding Requirement For Payments to Contractors with ITINs

Effective January 1, 2010, any “payer” that pays more than \$1,500 to an independent contractor who holds an Individual Taxpayer Identification Number (ITIN) must withhold 4 percent of that pay.

ITINs are issued by the Internal Revenue Service to individuals who are not eligible to receive a social security number.

Always starts with a “9”.

Payers include businesses, organization or other individuals.

Chapter 476 (S.B. 1006, Laws 2009).



PART FIVE

North Carolina Procedure

Could A Responsible Person Be Personally Liable For Uncollected Sales Taxes Or The Failure To Do The 4% Withholding?

Under N.C.G.S. 105-242.2, certain "responsible persons" are personally liable for **sales taxes** that have not been collected if the **person knew, or should have known**, that the sales tax was not being collected. N.C.G.S. 105-242.2(b)(2).

Likewise, N.C.G.S. 105-242.2(b)(4) imposes personal liability on responsible persons for unpaid **income taxes required to be withheld** by the business.

Presumably therefore, a responsible person could be held personally liable for the failure to withhold the 4% income tax on compensation paid to the above-mentioned "payees" regardless of whether the corporate officer knew or should have known of the withholding obligation.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 52

I. State Law, and Not Federal Internal Revenue Code Statutes, Determines Whether a Taxpayer is a Bona Fide “Partner” in a Partnership, and Whether Transactions Between a North Carolina Partnership and Partner are “Disguised Sales”; Integon National Insurance Company vs. NCDOR, 20 REV 01001 (October 12, 2023).

Integon claimed North Carolina renewable property investment tax credits for its investment in Rockwood Capital V partnership.

Presumably from the OAH ruling, the NCDOR had argued that Integon wasn't a true “partner” of Rockwood, or that it engaged in some type of “disguised sale” transaction that would have made Integon ineligible for claiming NC renewable investment tax credits.



PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 52

In reliance upon the North Carolina Supreme Court's decision in **Fidelity Bank vs. NCDOR (370 NC 10) (June 13, 2017), 803 SE 2d 142**, the OAH determined, by virtue of the record before it, that Integon had made capital contributions to Rockwood V, and that the organizational documents and partnership tax returns reflected Integon's status as a partner of Rockwood V thus entitling it to NC renewable investment tax credits.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 52

In **Fidelity Bank vs. NCDOR (370 NC 10) (June 13, 2017), 803 SE 2d 142**, the North Carolina Supreme Court held that, where the North Carolina tax statutes do not expressly incorporate specific Internal Revenue Code provisions for use in determining a taxpayer's obligation to pay North Carolina taxes, the court must construe the North Carolina tax statutes based on their clear meaning and not based on any definitions or defined terms contained in the Internal Revenue Code.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS
PAGE 52

II. McCabe v. NC Department of Revenue, Office of Administrative Hearings, 19 REV 06681 (March 30, 2021).

In McCabe, the NCDOR questioned:

- (1) whether the McCabe’s transaction with a partnership should be characterized as “disguised sale” under Section 707 of the Internal Revenue Code, and
- (2) whether certain allocations of tax credits, pursuant to the terms of a Partnership Agreement, met the “substantial economic effect” test under Section 704 of the Internal Revenue Code.
- (3) Whether McCabes were “bona fide” partners.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 52

Business Court Rules in Favor of McCabes, 21 CVS 5724 (April 6, 2023)



PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 52

Note: The NCDOR appealed the Business Court's decision in favor of the McCabes. However, in 2024, NCDOR withdrew its appeal. Final Decision on Remand (June 13, 2024).

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 52

Note: Private Letter Ruling February 24, 2014. The NCDOR rules that tax credits under N.C.G.S. 105-129.16A, that are allocated to partners of a partnership, may be applied against their North Carolina tax liability regardless of whether the taxpayers “materially participate” in the activity within the meaning of Section 469 of the Internal Revenue Code. The NCDOR determined that tax credits for investing in NC renewable energy property under old N.C.G.S. 105-129.16A is not contingent on any provision of the federal income tax law related to “passive activities” under Section 469 the Internal Revenue Code, and therefore North Carolina renewable energy tax credits would not be disallowed for North Carolina income tax purposes regardless of whether the taxpayer’s investment was “passive” or “non-passive”.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

71

PAGE 53

III. NC Department of Revenue Directive TA-18-1 Explains North Carolina’s Version of the “Mail Box” Rule.

This Directive (from August 2018) explains how North Carolina has adopted the federal “Mail Box Rule” under Section 7502 of the Internal Revenue Code.

This Directive states that an “otherwise late” tax return or “other document” is deemed to be timely filed **only** if:

1. The document is **actually delivered** to the NCDOR, albeit after its due date; or
2. The document is sent to the NCDOR via registered or certified mail or private delivery services (such as Fedex).



According to the Directive, an “**other document**” includes

- an original or amended return;
- a tax payment;
- a claim for tax refund; and
- a Request for Departmental Review of a Notice of Assessment.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

IV. Timely Filing A Petition Before the Office of Administrative Hearing (OAH) To Challenge a Notice of Final Determination; All Medical Personnel, Inc. v. NC Department of Revenue (19 Rev. 06371 (August 28, 2020),

PAGE 54

On September 18, 2019, the taxpayer received a Notice of Final Determination (“NFD”) from the NCDOR upholding a proposed tax assessment.

To contest the NFD, the taxpayer was required to file a Petition with the Office of Administrative Hearings within sixty (60) days, or by **November 18, 2019**.

The taxpayer timely mailed a Petition on **October 1, 2019** to the “State’s Mail Service Center”.

Unfortunately, the record does not show exactly to what address the OAH Petition was mailed.

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

Timely Filing A Petition Before the Office of Administrative Hearing (OAH) To Challenge a Notice of Final Determination; All Medical Personnel, Inc. v. NC Department of Revenue (19 Rev. 06371 (August 28, 2020),

On **November 20, 2019**, the taxpayer contacted the OAH to inquire about the status of its Petition.

The Deputy Clerk of the OAH advised the taxpayer that it had not received any Petition.

The taxpayer then emailed a copy of the Petition to the OAH which the clerk accepted and filed that day.



75

Timely Filing A Petition Before the Office of Administrative Hearing (OAH) To Challenge a Notice of Final Determination; All Medical Personnel, Inc. v. NC Department of Revenue (19 Rev. 06371 (August 28, 2020),

OAH grants the NCDOR Motion to Dismiss.

The Petition was not “filed” with the OAH **until November 20, 2019.**

Merely mailing the Petition does the taxpayer no good.

Under 26 NC Admin Code 3.0102(a)(2), the Petition has to be *received and accepted* by the Clerk within the sixty (60) day period.

With the OAH, there is no “mail box rule” and the mere receipt of mail by the NCDOR Service Center does not constitute a “filing” with the OAH.



OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS
PAGE 53

V. Petition Rejected Where It Was Filed By An Enrolled Agent; Burt Cox and Myra White vs. NCDOR, 19 REV 06234 (April 8, 2020).

Mr. Cox and Ms. White filed a claim for refund with the NCDOR.

The NCDOR issued its Final Notice denying the refund claim as being outside the statute limitations for obtaining a refund.

Then, a timely filed Petition was filed with OAH claiming that the NCDOR acted erroneously in denying the refund claim.

The Petition, however, was not signed by Mr. Cox or Mrs. White, but instead was signed by a “Janine Skariot”, who **was not a North Carolina licensed attorney**.

Accordingly, the AOH dismissed the taxpayer's Petition - even though the signor of the Petition (Ms. Skariot) **was an Enrolled Agent**.

VI. OAH Petitions Dismissed for Insufficient Pleadings.

A. Montague vs. NCDOR, 19 REV 05675 (March 5, 2020)

Mr. Montague applied for a tax refund for his alleged over paid taxes.

The NCDOR sent Mr. Montague a Notice of Denial of the refund claim based upon the expiration of the statute of limitations.

Mr. Montague then timely filed a Petition for a Contested Case before the OAH.
Case before the OAH.

A. **Montague vs. NCDOR, 19 REV 05675 (March 5, 2020)**

The Petition came in the form of a one sentence letter that read:

“I am filing a petition for a contested tax case hearing in accordance with Chapter 150(b), Article 3 of the NC General Statutes, regarding notice number: 5028-764-190-829”.

The Notice referenced in Mr. Montague's Petition was a Notice he had received from the NCDOR denying his refund request based on the statute of limitations expiration.



Montague vs. NCDOR, 19 REV 05675 (March 5, 2020)

The OAH dismissed Mr. Montague's Petition on the basis that the Petition

“failed to allege any agency error” and for not stating facts “tending to show the agency violated one or more provisions of the North Carolina Administrative Procedure Act.”

PART SIX
OFFICE OF ADMINISTRATIVE HEARINGS DECISIONS

PAGE 55

VII. OAH Petitions Dismissed for Insufficient Pleadings.

B. Gatewood vs. NCDOR, 20 REV 03500 (November 17, 2020). Mr. Gatewood filed a claim for refund.

NCDOR denied refund claim for falling outside the statute limitations for claiming a refund and issues a Final Notice to Mr. Gatewood.



81

Mr. Gatewood then timely filed a Petition for a Contested Tax Case before the OAH and stated in his Petition as follows:

“I disagree with the determination to deny my request for a refund for the year 2015 tax return. I would like to file a petition for a contested tax case hearing in accordance with Chapter 150B, Article 3 of the NC statutes. I have provided NCDOR the proper documentation to process my 2015 income tax return and I feel payment should be issued to me ASAP. I paid in taxes and I feel I am entitled to a refund.”



The OAH dismissed the Petition saying that Mr. Gatewood:

“failed to allege facts tending to establish that the Department committed any wrongful act, much less that it acted in violation of... of the general statutes...other than expressing his belief that he is entitled to the requested refund simply because he paid taxes.

[Mr. Gatewood] does not allege that the 2015 refund claim was timely, nor denied that it was filed outside the statute of limitations...The failure of Petitioner to assert facts tending to show agency error renders the petition fatally defective and, thus subject to dismissal”.

These results seem unfairly harsh considering that the taxpayers represented themselves “pro se”.

And besides, what did the OAH *think* that Mr. Montague and Mr. Gatewood were complaining about?

PART SEVEN
RECENT NCDOR PRIVATE LETTER RULINGS
PAGE 58

1. NCDOR Private Letter Ruling, March 8, 2024; What Equipment Purchases by Contractor in a Construction Contract With the Taxpayer Are Exempt as Mill Machinery – SUPLR 2004-0005.

Facts: Here, the taxpayer was constructing a manufacturing facility and hired a contractor to build the facility and purchase equipment as part of the overall construction project. The taxpayer sought a ruling as to whether the following items, purchased by the contractor and installed into the newly constructed facility, would be exempt as mill machinery:

1. Electrical equipment and electrical power distribution equipment;
2. Compressed air systems; and
3. HVAC equipment.

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS
PAGE 58

Ruling: In the private letter ruling, the NCDOR determined:

1. Electrical equipment was not exempt mill machinery. Here, the electrical equipment was designed for the **general distribution of power** to the new manufacturing plant. Under Sales and Use Tax Bulletin 57-3, only electrical equipment that is *actually affixed to mill machinery* is exempt mill machinery.

Here, the PLR request did not describe any electrical equipment that would be actually affixed to any piece of mill machinery, but instead the ruling request described the electrical equipment as being used for the general distribution of power to the building, including the assembly line. The electrical power conduit and electric wiring that ran from electrical rooms but would not be affixed to any piece of mill machinery, but instead worked for the general distribution of power to the assembly area building. Thus, the electrical equipment did not qualify under SUTB 57-4(1).

PART SIX

86

RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 58

2. Compressed air system. In the ruling, the compressed air system was to be used to support the tools that would be utilized to assemble the taxpayer's products. The NCDOR determined that the compressed air system would be a non-exempt “accessory” to mill machinery because the system would be used to drive the tools that would be utilized to assemble product. Therefore, compressed air system was not mill machinery.
3. HVAC equipment. Here, the HVAC equipment qualified as mill machinery since the taxpayer’s assembled products had specific temperature and humidity requirements during the assembly processes and these HVAC units were central to control the specific humidity and temperature conditions of the factory. Therefore, they qualified as mill machinery under SUTB 57-3(a).

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

2. NCDOR Private Letter Ruling January 31, 2024; Live Content Via Audio Video Connection Subject to Sales Tax – SUPLR 2024-0004.

Facts: The taxpayer operated websites which provided users the ability to interact live via an audio video connection. The taxpayer’s website allowed users to see and hear taxpayer’s content and interact by way of a live chat. Nothing would be downloaded by the customer.

Ruling: NCDOR rules that the taxpayer's customers pay for live audio and video and the taxpayer is providing a live performance and uploading original content for the entertainment of its customers and subscribers. Thus, the live video and video content meets the definition of “digital audiovisual work” which is then subject to North Carolina sales and use tax.

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

3. **PLR January 31, 2024; Sale of At-Home Testing Kits And Analytical Services Are Not Subject to Sales Tax – SUPLR 2024-0002.**

Facts: The taxpayer was an online provider of analytical reports to individual customers who purchased home testing kits from the taxpayer. Once a North Carolina customer purchased a testing kit, the customer mailed the kit from their home to the taxpayer's laboratory, where specimens are reviewed and processed and analyzed. Customers can then access their individual, personal reports through the taxpayer's website.

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

Ruling: Here, the use of the testing kit was integral to the provision of the taxpayer's services. NCDOR ruled that taxpayer was actually making direct sales of analytical reports to its North Carolina customers, but these "services" are not subject to North Carolina sales tax under in NCGS 105-164.4. For the kits, which were used to obtain the specimen and were then returned to the taxpayer for proper processing, the kits were merely to be used by the taxpayer to perform analytical services. Since the kits were not sold separately to its customers, no sales tax should be assessed on the sale of the services or the test kits.

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

4. **PLR January 3, 2024; Sale of Digital Property and Not Sale of the Software Service; Subscription Fees and Bundled Transactions – SUPLR 2004-0003.**

Facts: The taxpayer was a technology-based training services company that charged subscription fees to allow its customers to license pre-written software through a licensing agreement on the taxpayer's technology landform. The software allowed customers to access “content” on the taxpayer’s website. The content is remotely accessed and not downloaded and therefore no software was actually transferred to the end-user.

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

The technology platform contains a database of instructional content generally shown in the form of “live streaming content” and digital works. Each platform allows their user to search, select and curate the instructional content in which they were interested. No individual works or items were ever purchased, but instead the entire library database of content was purchased through a subscription license. The purpose of subscribing was to gain access to the overall platform and software that allows a user to select content applicable to their specific situation pulling from the entire database.

The issue was whether the subscription fees were subject to sales tax as the sale of digital property?



PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

Ruling: Here, the taxpayer's customers sought and received access to digital content when they pay the subscription fee and therefore the transaction was subject to sales and use tax as the sale of the digital product. The NCDOR ruled that the taxpayer was not selling software as a service when it provided access to the digital content nor was it providing an information service. The taxpayer's customers were not purchasing underlying software used by the taxpayer to deliver content.

PART SIX
RECENT NCDOR PRIVATE LETTER RULINGS

PAGE 59

However, one standalone service provided by the taxpayer would not be normally subject standalone to sales and use tax. The taxpayer also would allow its customers access to the taxpayer's website to allow the customers to practice [music or yoga] found in some of the digital content. Customers did not download the software, but instead would access it remotely on the taxpayer's website. Therefore, the standalone sale of this product would be the sale of “software as a service” which is a nontaxable service in North Carolina. However, since this product was sold for one non-itemized price with a taxable digital price, this constituted the sale of a “bundled transaction”. Therefore, the sales tax would apply to the full sales price of the bundled transaction under N.C.G.S. 105-164.4D(a).

PART SEVEN

RECENT NCDOR PRIVATE LETTER RULINGS

5. Roof Repair Not a “Capital Improvement” Exempt From Sales Tax, Even Though Customer Capitalized the Cost for Federal Tax Purposes. February 25 2021- SUPLR 2021-0011.

Facts: Taxpayer makes substantial roof repairs to customer’s commercial building. Single roof repair project at great expense, although entire roof was not replaced.

Customer capitalizes the cost of roof repairs for federal tax purposes.

Ruling: Although customer capitalized the roof repair costs for federal tax purposes, because the roof repair did not constitute “installation of **equipment** or a **fixture** that is attached to real property” under N.C.G.S. 105-164.3(31)(d), and since the roof was not fully replaced, the fact that customer capitalized the cost of the roof for federal tax purposes doesn’t qualify the roof repair as a “capital improvement” exempt from sales tax.

PART SEVEN

95

RECENT NCDOR PRIVATE LETTER RULINGS

6. **Purchase of Sorting, Bailing and Weighing Equipment Not Exempt from Sales Tax as Mill Machinery Because Taxpayer is not a “Manufacturer”. June 9, 2022 – SUPLR 2022-0003.**

Facts: Taxpayer collects used goods and undertakes following activities to process used goods into products that can be sold to end-use customers:

Sorting – taxpayer uses specialized machinery to sort damaged and undamaged goods into different categories.

Bailing – taxpayer uses equipment to crush and compact materials into compressed bales in specific sizes.

Weighing – taxpayer uses calibrated scales to determine product weight.

Ruling: Taxpayer is not a manufacturer, and therefore its purchase of equipment are not exempt from sale tax under mill machinery exemption.



RECENT NCDOR PRIVATE LETTER RULINGS

7. **Taxpayer is a “Contract Manufacturer” Whose Purchase of “Blast Freezing” Equipment for its “Blast Freezing” Operations for Food Manufacturers are Mill Machinery Exempt from Sales Tax. November 2, 2022 – SUPLR 2022-0006.**

Facts: Taxpayer operates a facility in North Carolina with blast freezing operations.

Taxpayer takes possession of customers’ perishable foods and blast freezes the goods to below 0 degrees before goods are shipped back to customers.

Ruling: Taxpayer is a contract manufacturer when it performs blast freezing process on customer’s goods for manufacturers of those goods. Thus, taxpayer’s purchase of blast freezing equipment is mill machinery exempt from sales tax.

RECENT NCDOR PRIVATE LETTER RULINGS

8. Purchase of Certain HVAC Units Qualify for Mill Machinery Exemption – January 26, 2021 – SUPLR 2021-0001.

Facts: Taxpayer is manufacturer of extruded foam products sold to end-users or as components for other manufacturers. The taxpayer's products are used in the following industries: construction, packaging, furniture and fitness.

Taxpayer purchases an HVAC unit to be installed above its production area and the purchased HVAC unit operates separate and apart from other HVAC equipment in taxpayer's facility.

Ruling: Taxpayer is a manufacturer and its purchase of HVAC equipment is eligible for mill machinery sales tax exemption under N.C.G.S. 105-164.13(5e).

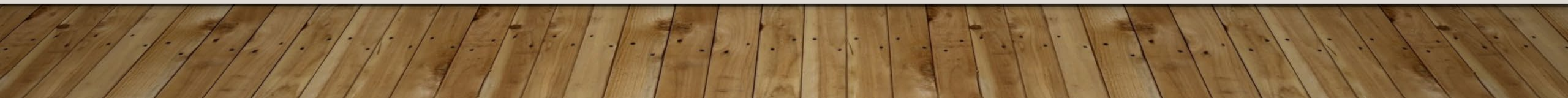


RECENT NCDOR PRIVATE LETTER RULINGS

9. **Contractor's Purchase of Water Purification Device to Perform Construction Contract with "Manufacturing Plant" is Exempt as Mill Machinery. May 19, 2021 – SUPLR 2021-0021.**

Facts: Taxpayer purchases a water purification device to perform a construction contract for a customer's manufacturing plant.

Ruling: Taxpayer's purchase of a water purification device, that is installed by the taxpayer into a newly-constructed water purification plant, that in turn is considered a manufacturing plant, is exempt from sales tax under mill machinery exemption of N.C.G.S. 105-164.13(5e)6.



RECENT NCDOR PRIVATE LETTER RULINGS

10. **Recycler is a “Manufacturer” and thus Purchase of Equipment Used In Its Production Process is Exempt from Sales Tax Under Mill-Machinery Exemption. October 29, 2021 - SUPLR 2021-0026.**

Facts: Taxpayer purchases equipment used in its recycling business. Taxpayer produces a variety of new, different and distinct products with a commercial value in excess of the original raw materials.

Ruling: Taxpayer applies its skill and labor to convert collected paper, plastic and metals into finished goods that conform to industry and customer standards. Thus, taxpayer’s recycling activities constitute “production” and its purchase of certain equipment used in its recycling process is mill machinery exempt from sales tax.

PART SEVEN

100

RECENT NCDOR PRIVATE LETTER RULINGS

11. Purchases of Equipment by Contract Manufacturer Performing Contracts to Provide Anodizing Services to Manufacturing Plant is Exempt Mill Machinery. November 8, 2021 – SUPLR 2021-0027.

Facts: Taxpayer purchases equipment to fulfill contracts with manufacturing industries or plants to provide aluminum anodizing services for commercial and individual customers.

Ruling: Taxpayer is a “contract manufacturer” performing anodizing service contracts with manufacturing industries or plants.

So, purchase of equipment by taxpayer is “mill machinery” exempt from sales tax, as sale of mill machinery to a contractor for its use in performing a contract with a manufacturing plant. N.C.G.S. 105-164.13(5e)b.



RECENT NCDOR PRIVATE LETTER RULINGS**12. Sales of Educational On-Line On-Demand Courses Subject to Sales Tax. June 22, 2021 – SUPLR 2021-0023.**

Facts: Taxpayer offers on-line and on-demand courses to students in public and private schools.

Ruling: Receipts from sales of on-line courses constitute sales of digital audiovisual works and thus are taxable sales of digital property under N.C.G.S.105-164.3(59).



RECENT NCDOR PRIVATE LETTER RULINGS

13. The Following Constituted Taxable Sales of “Digital Property” Under N.C.G.S. 105-165.3(5) and (33) – SUPLR 2021-0019.

Ruling: Subscription fees paid to access industry research in the cloud through a web portal. April 29, 2021.

Ruling: Charges for on-line training courses accessed on digital platforms, including on the taxpayer’s website. March 20, 2020.



RECENT NCDOR PRIVATE LETTER RULINGS

14. Subscription Fees to Access On-Line Training Courses are Subject to Sales Tax. February 20, 2020 – SUPRL 2020-0003.

Facts: Taxpayer provides on-line training courses via subscription.

Taxpayer contracts with subject matter experts who create pre-recorded training courses.

Taxpayer charges monthly or annual subscription fee to customers in exchange for providing subscribers with a “non-exclusive, non-transferrable license” to use taxpayer’s site.

Ruling: Taxpayer’s subscription fees are taxable sales of digital property (audiovisual works) subject to sales tax.



RECENT NCDOR PRIVATE LETTER RULINGS

15. **Sales of “Help Desk Services” are Sales of Service Contracts Subject to Retail Sales Tax. July 27, 2022 – SUPLR 2022-0004.**

Facts: Taxpayer provides Information Technology Services to business organizations under a service level agreement (an “ITS Plan”).

The ITS Plan allows customers to “outsource” all of their IT needs with taxpayer’s virtual, remotely accessed IT infrastructure. Taxpayer’s technology assets are maintained in a facility located outside of North Carolina.



RECENT NCDOR PRIVATE LETTER RULINGS

In addition to providing its customers with data storage, data security and data protection, taxpayer also provides “Helpdesk” technical support for a fee.

Ruling: Taxpayer’s sale of Helpdesk services are taxable sales of service contracts and thus subject to sales tax.

RECENT NCDOR PRIVATE LETTER RULINGS

16. Customer Fees Charged to Customers Who Purchase Items from Taxpayer are Subject to Sales Tax. November 12, 2019 – SUPLR 2019-0002.

Facts: Taxpayer plans to charge a fee to customers who purchase an item.

Customer fee is a percentage of the charge for the item and would be added at the time of purchase.

Customer fee would be “separately stated” and charged at the time of purchase.

Ruling: Customer fee is an expense of the retailer and is part of the sales price of the item. So, the customer fee is subject to retail sales tax.



RECENT NCDOR PRIVATE LETTER RULINGS

17. Auctioneer's Administrative Fees Subject to Sales Tax. February 28, 2020 – SUPLR 2020-0004.

Facts: Taxpayer sells new and used goods through unreserved public auctions. Owners of the goods (consignors) consign the goods to the taxpayer for auction, but reserve title to the consigned items.

Taxpayer merely acts as “selling agent” for owners of the items.



RECENT NCDOR PRIVATE LETTER RULINGS

Taxpayer collects sales tax from buyers at auction but proposes a new arrangement where taxpayer also will charge an administrative fee to buyers for the “many valuable services” it offers to the buyer.

The new administrative fee will be based on the sales price of the item and will be “separately stated” on buyer’s invoice.

Ruling: Administrative Fee is part of the sales price subject to sales tax.

