



North Carolina Update: State Tax Developments Spring 2014

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This North Carolina update discusses significant legislative, judicial, and administrative developments in North Carolina tax laws during the period October 2013 through April 2014, including the outlook for the upcoming legislative session and recently issued guidance from the North Carolina Department of Revenue.

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I. Income and Franchise Taxes

Adjustments for Code Section 179 Expenses

For tax years 2010 through 2013, North Carolina did not fully conform to federal law regarding expenses under Section 179 of the Internal Revenue Code (the "Code"). In 2013, the General Assembly added G.S. 105-130.5B, which governs adjustments to be made where North Carolina decoupled from federal accelerated depreciation and expensing for the tax year. Under G.S. 105-130.5B(c), "A taxpayer who places section 179 property in service during a taxable year listed in the table below must add to the taxpayer's federal taxable income eighty-five percent (85%) of the amount by which the taxpayer's expense deduction under section 179 of the Code exceeds the dollar and investment limitation." For 2013, the table referenced in G.S. 105-130.5B(c) provided that the dollar limitation was \$25,000 and that the investment limitation was \$125,000.

As stated in the Important Notice, the Department has been advised by the staff of the General Assembly that there was a drafting error in the law regarding the investment limitation for 2013. According to staff, the General Assembly intended the North Carolina investment limitation for taxable year 2013 to be \$200,000. The Revenue Laws Study Committee has voted to recommend that the General Assembly change the North Carolina investment limitation for the taxable year 2013 to \$200,000 during the 2014 legislative session.

The Important Notice also includes a series of examples and explanations as to how the Department treats such expenses under North Carolina law for tax years 2010 through 2013, during which time North Carolina did not conform to the Code in its entirety with respect to Code

section 179.

Bonus depreciation

North Carolina is decoupled from accelerated federal bonus depreciation provisions for North Carolina corporate income tax purposes. The Department has recently published online guidance on the deductibility of bonus depreciation under North Carolina law in cases involving the transfer of assets on or after January 1, 2013. This guidance is available at the following website:

http://www.dorncc.com/taxes/bonus_asset.html

Exception to General Statute of Limitations for Refund.

The Department has published guidance on its website concerning legislation effective January 1, 2014 that provides an exception to the general statute of limitations for obtaining a refund of an overpayment due to a contingent event or an event or condition other than a contingent event. A “contingent event” is litigation or a state tax audit initiated prior to the expiration of the statute of limitations which prevents a taxpayer from possessing the information necessary to file an accurate and definite request for refund of an overpayment. An “event or condition other than a contingent event” is an event or condition other than litigation or a state tax audit that has occurred and prevents the taxpayer from filing an accurate and definite request for refund of an overpayment within the general statute of limitations. The guidance provides procedures for claiming the refund and is available at the following link:

<http://www.dorncc.com/taxes/certainevents.html>

Trends/Outlook

The “short session” of the North Carolina General Assembly will convene on May 14, 2014 for what the leadership has represented should be a relatively brief session devoted to adopting modifications to the biennial budget adopted in 2013, mostly technical revisions to the tax code in the wake of last year’s overhaul of the tax system, recommendations of the Revenue Laws Study Committee and other study committees, and dealing with bills that passed one chamber but not the other last year. Given the candidacy of the Speaker of the House for the US Senate, it is expected that the House will be particularly interested in a brief session; no such pressures are on the Senate, which may give it leverage in the typical inter-chamber negotiations.

It is expected that the Revenue Laws Study Committee will recommend replacing North Carolina’s unique “net economic loss” deduction with a State net loss deduction for taxable years beginning on or after January 1, 2015. Under current NC law, for State tax purposes, a corporation is allowed a net economic loss (“NEL”) deduction equal to the amount by which allowable deductions for the year other than prior year losses exceed income from all sources in the year, including nontaxable income. The State deduction may be carried forward 15 years; any loss carry forward must first be offset by nontaxable income, including allowable deductions. The draft bill does three things to simplify the calculation:

- a) It replaces the NEL with a State net loss calculation that is more comparable to

the federal NOL;

b) It removes the requirement that an NEL carried forward to taxable years beginning on or after January 1, 2015 first be offset by nontaxable income;

c) It instructs the Secretary of Revenue to apply the standards under sections 381 and 382 of the Code when determining to what extent a loss survives a merger or an acquisition.

North Carolina's NEL has been the subject of much confusion and criticism, and the proposed change should be welcomed by the business community. The one potential hurdle to passage lies in the State's tight budget. Passage of the legislation would have some effect on the budget in future years. Nevertheless, passage seems likely.

Also, the Revenue Laws Study Committee will recommend draft legislation that would make "administrative and clarifying" changes in areas affecting major recycling facility tax credits, the sales tax on accommodations (of interest to the hospitality and online travel industry), sales tax on vending machines, sales tax on manufactured and modular homes, sales tax on video programming and piped natural gas, and the annual due date for captive insurance tax returns, provide for central assessment of the property tax on mobile telecommunications equipment, and address various other issues.

II. Transactional Taxes

The Department has published guidance on the following subjects relating to sales and use tax and other transactional tax law changes made during the 2013 session of the General Assembly:

- Prepared food sold to a college student attending an institution of higher education
- Manufactured homes
- Modular homes
- Admission charges for certain live performances, motion pictures or films, museums, cultural sites, gardens, exhibits, shows, or similar attractions
- Newspapers
- Service contracts
- Optional service contracts for portable toilets
- Service contracts for motor vehicles subject to highway use tax
- Specialty markets, flea markets, fairs, festivals, sporting events, entertainment events, and other events

These publications are available on the Department's website for the Sales and Use Tax Division: <http://www.dorn.com/taxes/sales/index.html>

In addition, the Department has launched the Trust Tax Recovery Program, which will offer penalty and collection fee waivers as well as payment plans for taxpayers that have liabilities for sales taxes, as well as other trust taxes such as withholding taxes. As stated in online guidance published February 5, 2014, "Businesses that file and pay all outstanding taxes within the payment

plan terms may have their penalties and collection fees waived. Fees and penalties may be reinstated if program participants fail to file or pay future taxes as required.”

For more information, visit this website:

<http://www.dorn.com/press/2014/trusttax.html>

Trends/Outlook

The Revenue Laws Study Committee will recommend legislation to the General Assembly to address some of the administrative issues arising from the expansion of the sales tax base to include the sales price of a service contract.

III. Property Tax

In re Appeal of Pace/Dowd Properties, Ltd.

In March 2014, the North Carolina Court of Appeals issued a decision in *In re: Appeal of Pace/Dowd Properties Ltd.*, --- N.C. App. ---, 2014 N.C. App. Lexis 267 (Mar. 18, 2014) affirming the ruling of the North Carolina Property Tax Commission (“PTC”) ruling that Union County (the “County”) utilized an arbitrary method of appraisal in assessing the value of two large parcels of undeveloped land. The County assessed the parcels in 2008 using comparable sales from 2004, 2005, and 2006, but failed to account for a subsequently implemented limitation on the issuance of new water/sewer connections in the County that affected the property.

Because N.C. Gen. Stat. § 105-317 requires counties to determine the value of land in accordance with, *inter alia*, the “water privileges” attached thereto, the PTC held that the County had utilized an arbitrary method of valuation by failing to account for the water/sewer limitations. The Court of Appeals subsequently upheld this decision after concluding that the taxpayer had presented sufficient evidence to substantiate the County’s failure and support the PTC’s conclusion.

IV. Local Privilege Tax Update

North Carolina’s municipalities have the authority to levy a privilege tax on certain businesses. The tax is administered in widely disparate ways by cities and towns in North Carolina, and some municipalities have moved to impose a significant gross receipts tax on a variety of businesses, subject to numerous exceptions and limits imposed by state law. The Revenue Laws Study Committee is expected to recommend the replacement of the existing patchwork quilt with a new authority for cities to levy a business tax of up to \$100 on each business location within a city. The legislation would also repeal the more limited county authority to levy a privilege license tax. The new legislation would become effective July 1, 2015.

Business interests seem reasonably united in support of the proposal. Cities are opposed because of the potential revenue loss. Although the legislation may face some opposition and potential

amendment during the short session, there seems to be a good chance of passage.

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