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PUBLICATIONS & ALERTS

2019 NORTH CAROLINA TAX LEGISLATION

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This Alert summarizes the more significant tax provisions enacted by the North Carolina General Assembly in 2019. The most important tax changes were originally included in House Bill 966, the 2019 Appropriations Act (the “Budget Bill”). The Budget Bill was ratified in June and presented to the Governor. The Governor vetoed the bill, and, although the House overrode the veto, the Senate, as of this writing, has not. Many of the Budget Bill’s tax provisions were incorporated into other bills, principally Senate Bill 577, which have been enacted. Although the General Assembly reconvenes on November 13, it is not expected to take up any further tax legislation this year.

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IRC Update

Although federal adjusted gross income and federal taxable income are the starting points for computing North Carolina taxable income for individuals and corporations, respectively, the North Carolina Constitution prohibits automatic conformity to the Internal Revenue Code (the “Code”). As a result, the General Assembly annually updates the reference to the Code in the North Carolina Revenue Act in order to incorporate some or all of the changes made to the Code during the preceding year. The 2019 General Assembly updated the Code reference from February 9, 2018 to January 1, 2019.^[1] As a result, North Carolina conforms to the following statutes amending the Code enacted after February 9, 2018: the Consolidated Appropriations Act of 2018,^[2] the Tribal Social Security Fairness Act of 2018,^[3] the Airport and Airway Extension Act of 2018 (Part II),^[4] the FAA Reauthorization Act of 2018^[5] and the SUPPORT for Patients and Communities Act.^[6]

Individual Income Tax Changes

Increase in Standard Deduction

The standard deduction has been increased by 7.5% for the 2020 and later tax years. Beginning in 2020, the standard deduction will increase from \$20,000 to \$21,500 for joint filers, from \$15,000 to \$16,125 for heads of households and from \$10,000 to \$10,750 for single filers and married couples filing separately.^[7]

Qualified Charitable Distributions

Under federal law, a taxpayer who is at least 70½ may exclude from income up to \$100,000 in IRA charitable distributions.^[8] North Carolina had decoupled from this provision. As a result, a taxpayer claiming the federal exclusion was required to include the distribution in North Carolina income and could then claim a charitable contribution deduction as part of the taxpayer's North Carolina itemized deduction.^[9] This decoupling provision has been unwound so that North Carolina now conforms to the federal law (income exclusion/no deduction), effective for the 2019 and later tax years.^[10]

Franchise Tax Changes

Holding Company Definition

The franchise tax calculated under the net worth franchise tax base is capped at \$150,000 for holding companies.^[11] A holding company currently is defined as a corporation that has no assets other than the stock of controlled subsidiaries or that receives more than 80% of its gross income from controlled subsidiaries.^[12] The holding company definition has been narrowly expanded to include a corporation that (1) either owns copyrights, patents or trademarks that comprise more than 80% of its assets, or derives royalty and license fee revenues that represent more than 80% of its gross income and (2) is wholly-owned by a manufacturing company that generates more than \$5 billion in revenue from manufacturing and that includes in its net worth franchise tax base an investment in a subsidiary that owns copyrights, patents or trademarks.^[13] This change is effective beginning with the 2020 franchise tax year reported on 2019 corporate income tax returns.^[14]

Apportionment

Market-based Sourcing

The General Assembly has finally enacted market-based sourcing for apportioning the corporate income tax and the franchise tax net worth base, effective for taxable years beginning on or after January 1, 2020.^[15] Under market-based sourcing, receipts would be sourced to the location of the taxpayer's market. If the market cannot be determined, the receipts would be sourced based on a method of reasonable approximation. If the source of a receipt cannot be reasonably approximated, the receipt must be excluded from the denominator of the apportionment fraction.^[16]

North Carolina already uses market-based sourcing rules to source receipts from the sale of tangible personal property. However, service receipts are currently sourced by reference to where the activities that produce the income take place. Under the new market-based sourcing rules, these receipts will be sourced to the place where the services are delivered. With respect to receipts from intangibles, current law simply begs the question by providing that such receipts are sourced to North Carolina if they are "received from sources within this State."

[17] Under the new law such receipts will be sourced based on where the intangible is used. Marketing intangibles are considered to be used in North Carolina to the extent the marketed products are purchased by North Carolina customers. Receipts from the sale of an intangible would be sourced based on where the intangible is used.[18] Special market-based sourcing rules are provided for broadcasters,[19] banks,[20] natural gas pipeline companies[21] and electric power companies.[22]

While market-based sourcing provides an income tax benefit to profitable companies with a significant in-state presence and a significant out-of-state market, it has the opposite effect on companies operating at a loss, since a smaller portion of their losses will be apportioned to the state. To mitigate the impact of market-based sourcing on loss corporations, the new law permits a corporation with a state net loss at the end of 2019 to elect to continue sourcing receipts from services under the income producing activities test of current law until its losses are used up or expire. The election must be made on the 2020 tax return and is irrevocable. The election applies only for income tax purposes, and the franchise tax net worth base is apportioned as if the election had not been made.[23]

The Department of Revenue (the “Department”) issued proposed market-based sourcing rules in 2017, the effectiveness of which was contingent on future enactment of market-based sourcing legislation. These rules will now become effective beginning in 2020, but the Department is required to revise the rules to reflect differences between the market-based sourcing legislation proposed in 2017 and the market-based sourcing rules that have been enacted.[24]

Sales Tax Changes

Wayfair Codification

The Supreme Court’s decision in *South Dakota v. Wayfair, Inc.*[25] permitted states to require remote sellers making significant sales to in-state customers to collect sales and use taxes on such sales. Shortly after the *Wayfair* decision was released, the Department issued a directive announcing that it would begin requiring a remote seller to collect North Carolina sales tax if the remote seller had more than \$100,000 in North Carolina sales or at least 200 separate sales transactions sourced to North Carolina.[26] The General Assembly has codified the directive’s \$100,000/200 transaction threshold.[27]

Marketplace Facilitators

Even before *Wayfair*, many large online retailers were collecting sales tax voluntarily or because they had physical nexus with the state. However, *Wayfair* also raised the possibility that states could require online marketplace providers to collect tax on sales made over their platforms by small third party sellers who individually fall below the \$100,000/200 transaction threshold. The General Assembly considered requiring marketplace providers to collect taxes on facilitated sales in 2017, but the bill was not enacted.[28]

The sales tax law has now been extended to impose sales tax collection responsibility on marketplace facilitators. A marketplace facilitator is defined as a person who (1) owns or operates a physical or electronic platform or other marketplace on which the items of another person (the “marketplace seller”) are listed or made available for sale and (2) facilitates the sales of the marketplace seller’s items. Facilitation includes collecting or processing payments or making payment processing services available to customers.[29]

A marketplace facilitator must collect sales tax on all facilitated sales if it satisfied the \$100,000/200 transaction threshold for the current or the preceding calendar year. Direct sales by the facilitator as well as facilitated sales by marketplace sellers are counted in determining whether this threshold is met.[30]

A marketplace facilitator must furnish marketplace sellers with monthly information about the gross sales and number of transactions with respect to facilitated sales made by or on behalf of the marketplace seller and that are sourced to North Carolina. The marketplace facilitator may provide the report in any format.[31]

Marketplace facilitators are protected from class action lawsuits brought on behalf of customers alleging overcollection of tax by the facilitator on facilitated sales.[32] In addition, marketplace facilitators may not be assessed for failures to collect the proper amount of tax due because of incorrect information supplied by the marketplace seller.[33] No relief is available, however, if the marketplace seller is also the facilitator or an affiliate of the facilitator or if the transaction at issue was covered by specific written advice issued to the facilitator by the Department.[34]

These provisions are effective February 1, 2020 and apply to sales occurring after that date.[35]

Accommodation Facilitators

The General Assembly has clarified the rules regarding the rental of accommodations through accommodation facilitators. Specifically, the bill expands the definition of “accommodation facilitator” to cover persons who list accommodations for a fee as well as persons who accept payment or credit card information from renters. The term also specifically includes real estate brokers.[36]

Each of the facilitator and the provider of the accommodation are required to collect tax on that portion of the rental payment it collects.[37] Thus, with respect to any given rental, either the provider, the facilitator or both may be considered the retailer. The provider is considered the retailer in any case where the person who collects payment either cannot be determined or is someone other than the provider or the facilitator.[38]

A special provision applies to accommodation facilitators that are operated by or on behalf of a hotel owner, operator or franchisor and that facilitates rentals solely for the related hotels (e.g., Hilton.com). These facilitators are not considered retailers required to collect tax even if they collect all or a portion of the payment for the accommodation. Instead, as under prior law, these facilitators should send the tax due on the sales price they collect to the provider (i.e., the related hotel) for remittance to the Department.[39]

All accommodation facilitators must file an annual report with the Department containing information about rentals facilitated during the year. The report is due by the end of March of the following year. The Department may not disclose a report except for disclosures authorized by statute.[40]

These provisions become effective February 1, 2020.[41]

Highway Use Tax on Vehicle Subscriptions

A retailer who purchases a motor vehicle for lease or rental may elect to pay tax on the gross receipts from the lease or rental of the vehicle in lieu of the highway use tax on the retail value of the vehicle. The rate of this alternative tax is 3% for long-term leases or rentals and 8% for short-term leases or rentals.[42]

New business models have emerged under which a customer pays a monthly subscription charge for the right to use a vehicle from the leasing company's fleet and to swap out the vehicles from time to time. The Department has taken the position that the short-term rate applies to these arrangements.

The taxation of these arrangements has been clarified by establishing a new 5% rate for vehicle subscriptions. A vehicle subscription is defined as a written agreement giving a customer the right to use and exchange vehicles in return for a subscription fee and the exclusive use of an agreed-upon number of vehicles at any given time. The term does not include a vehicle sharing service.^[43]

Other Sales Tax Changes

Numerous additional technical and clarifying changes have been made to the sales tax law, including the following:

- The sales tax imposed on digital property has been broadened by eliminating the requirement that a taxable digital item must have a tangible counterpart, effective October 1, 2019.^[44]
- The rules regarding the circumstances in which repair, maintenance and installation services provided by a real property manager under a property management contract are taxable have been clarified, effective July 26, 2019.^[45]
- A sales tax exemption has been enacted for limited service vehicle washes, effective October 1, 2019.^[46]
- A sales tax exemption has been enacted for equipment used in manufacturing natural and engineered stone countertops and similar items, effective October 1, 2019.^[47]
- A sales tax exemption has been enacted for incontinence supplies paid for by the state's Medicaid program, effective October 1, 2019.^[48]

Credits and Incentives

Non-shareholder Contributions to Capital

The federal Tax Cuts and Jobs Act (TCJA) repealed a long-standing Code provision excluding from the gross income of a corporation contributions to the capital of the corporation made by a government entity.^[49] Because of this change, government incentive grants, which were previously excluded from income, became taxable at the federal level. North Carolina did not decouple from this TCJA change and thus reduced the value of its own state and local government incentive grants.

New law allows corporate and individual taxpayers to deduct grants from the state's Job Maintenance and Capital Development Fund, Job Development and Investment Grant Program and the One North Carolina Fund in computing their state net income. These changes are effective for amounts received after 2018. ^[50]

Sunset Extensions

The following provisions, currently scheduled to sunset on January 1, 2020, have been extended until January 1, 2024:^[51]

- The historic rehabilitation tax credits.[\[52\]](#)
- The sales tax exemption for aviation gasoline and jet fuel sold to an interstate air business for use in commercial aircraft.[\[53\]](#)
- The sales tax exemption for sales of engines, engine parts, service contracts and repair, maintenance and installation services and certain other items to a professional motorsports racing team or sanctioning body or to persons providing engines to a professional motorsports racing team.[\[54\]](#)
- The refund for sales taxes paid by a professional motorsports racing team or sanctioning body on aviation gasoline and jet fuel.[\[55\]](#)
- The refund for 50% of the sales taxes paid by a professional motorsports racing team on tangible personal property (other than tires or accessories) that comprise a part of a professional motorsports vehicle.[\[56\]](#)

Limited Reenactment of Mill Rehabilitation Credits

North Carolina previously offered “mill rehabilitation” credits to taxpayers rehabilitating income- and non-income-producing certified historic structures that were part of a vacant manufacturing facility. These credits expired in 2015. A limited-scope mill rehabilitation credit has been reenacted, applicable to a specific rehabilitation project involving an income-producing property formerly used as a railroad station. The credit is available in 2021 and 2022 and then expires.[\[57\]](#)

Property Tax Changes

Builder Inventory Property Tax Exclusion

North Carolina provides property tax exclusions for increases in the value of builder-owned real property inventory attributable to the builder’s improvements. Under prior law, a builder was required to apply for this exclusion annually. Effective for property tax years beginning July 1, 2019, the annual exclusion application has been replaced by a one-time application.[\[58\]](#)

Insurance Tax Changes

Insurance Regulatory Charge

The insurance company regulatory charge for the 2020 calendar year has been fixed at its current rate of 6.5%.[\[59\]](#)

Compliance and Administration

Powers of Attorney

The Department has been directed to update its electronic data systems to store and recognize power of attorney registrations to ensure that notices are sent to a taxpayer’s representative at the same time they are sent to the taxpayer. The Department is required to report its progress on achieving this goal by January 31, 2020.[\[60\]](#)

Taxation of Out-of-State Businesses and Workers Engaged in Disaster Relief

Relief provisions have been enacted for out-of-state businesses and nonresident employees that enter the state temporarily to help restore critical infrastructure following a declared disaster at the request of a critical infrastructure company. A majority of the states have enacted similar relief provisions. Eligible businesses and employees are exempt from the corporate and individual income taxes, the franchise tax, the unemployment tax and the requirement to obtain a certificate of authority to transact business. These provisions are effective for disasters declared on or after August 1, 2019.^[61]

Collection Assistance Fee

The Department generally commences collection on tax debts that remain unpaid for 30 days after they become collectible. The Department generally sends a notice at the 30-day mark informing the taxpayer that a collection assistance fee may be imposed if the debt is not paid within another 30 days, i.e., 60 days after it becomes collectible. However, the Department is not allowed to impose the fee until the debt is at least 90 days old. To better align these time periods with the Department's practice, the law has been changed to provide for a 60-day rather than a 30-day notice period. Thus, under the new law, the notice period will expire 90 days after the debt becomes collectible, the same day the Department is permitted to impose the fee. This change is effective for tax debts that become collectible on or after January 1, 2020.^[62]

Innocent Spouse Relief

Before 1998, the Code provided that a spouse making a joint return could be relieved from liability resulting from a substantial understatement of tax by the other spouse. Under current federal law, an innocent spouse may be relieved from liability resulting from any understatement of tax (not just a substantial understatement), and in certain cases the innocent spouse may also be relieved from liability resulting from an underpayment of tax.^[63] North Carolina's innocent spouse statute provided relief to a spouse who qualified for federal innocent spouse relief "attributable to a substantial understatement." The North Carolina law has been changed to conform to the federal provision, effective for taxable years beginning on or after January 1, 2018.^[64]

Franchisor Reporting

The General Assembly has directed the Revenue Laws Study Committee to study issues regarding underreporting of sales tax by franchisees, including whether franchisors should be required to report information about their franchisees to the Department.^[65]

Contingent Refund Claims

A claim for refund generally must be filed within three years after the due date of the return or two years after payment, whichever is later. There are several exceptions to the general limitation period. One of these exceptions permits a taxpayer to file a contingent refund claim in certain circumstances where the taxpayer lacks adequate knowledge to file an accurate and definite refund claim. The contingent refund claim must be filed within the general limitation period and is thus not available if the general limitation period has expired even if another exception to the general limitation period is applicable. The statute has been revised to permit a contingent refund claim to be filed if the general limitation period has been extended due to another exception. This change is effective July 26, 2019.^[66]

Federal Determinations

If a taxpayer's federal tax return is corrected as a result of a federal determination in a manner that affects the taxpayer's state tax liability, the taxpayer must file an amended North Carolina return reflecting the federal change. The definition of a "federal determination" has been amended to clarify that the determination must be final. A federal determination is considered final when it is not subject to administrative or judicial review. In addition, a federal audit is considered final if the taxpayer does not timely file an administrative appeal with the IRS after receiving the audit findings or if the taxpayer has consented to any of the audit findings through a form or other written agreement with the IRS.^[67]

Criminal Tax Venue

A new law fixes the venue for all criminal tax law violations in Raleigh, effective for offenses committed on or after December 1, 2018.^[68] This reverses a change made in 2018 that established criminal offense venue at the location where the offense occurred.^[69]

What Did Not Happen

While many tax provisions originally included in the vetoed Budget Bill were incorporated into other bills and have become law, some Budget Bill tax provisions were not enacted. Most notably, the provisions in the Budget Bill reducing the franchise tax rate and eliminating the 55% of appraised value alternative franchise tax base^[70] were not enacted. Other Budget Bill tax provisions that were not enacted include (1) amendments to North Carolina's Personal Education Savings Account program,^[71] (2) expansion of the insurance company gross premiums tax to cover capitation payments made with respect to enrollees in the State Medicaid program or the NC Health Choice program^[72] and (3) expansion of the property tax exemption for antique cars.^[73]

For more information about the Alert, please contact a member of Smith Anderson's **Tax Group**, business lawyers who understand taxation.

^[1] See S56, S.L. 2019-6, §1.1; N.C. Gen. Stat. §105-228.90(b)(1b).

^[2] Pub. L. No. 115-141.

^[3] Pub. L. No. 115-243.

^[4] Pub. L. No. 115-250.

^[5] Pub. L. No. 115-254.

^[6] Pub. L. No. 115-271.

^[7] See S557, S.L. 2019-246, §1.(a); N.C. Gen. Stat. §105-153.5(a)(1).

^[8] See Internal Revenue Code ("IRC") §408(d)(8).



[9] See N.C. Gen. Stat. §§105-153.5(c2)(3) and 105-153(a)(2)a.

[10] See H399, S.L. 2019-237, § 1.(a); N.C. Gen. Stat. §105-153.5(a)(2) and 105-153.5(c2)(3).

[11] See N.C. Gen. Stat. §105-120.2(b).

[12] See N.C. Gen. Stat. §105-120.2(c).

[13] See S557, S.L. 2019-246, §2.(a); N.C. Gen. Stat. §105-120.2(c).

[14] See S557, S.L. 2019-246, §2.(b).

[15] Pursuant to N.C. Gen. Stat. §105-122(c1)(1), the net worth franchise tax base is apportioned using the same fraction applied for income tax purposes. This indicates that the market-based sourcing will become effective for the 2021 franchise tax year reported on the 2020 income tax return,

[16] See S557, S.L. 2019-246, §3.(a); N.C. Gen. Stat. §105-130.4(f).

[17] N.C. Gen. Stat. §105-134.4(f)(3)b.

[18] See S557, S.L. 2019-246, §3.(a); N.C. Gen. Stat. §105-130.4(f).

[19] See S557, S.L. 2019-246, §3.(b) and (d); N.C. Gen. Stat. §§105-130.4A and 105-122(c1).

[20] See S557, S.L. 2019-246, §3.(a) and (c); N.C. Gen. Stat. §§105-130.4(f2) and 105-130.4B.

[21] See S557, S.L. 2019-246, §3.(a); N.C. Gen. Stat. §105-130.4(s2).

[22] See S557, S.L. 2019-246, §3.(a); N.C. Gen. Stat. §105-130.4(s3).

[23] See S557, S.L. 2019-246, §3.(a) and (d); N.C. Gen. Stat. §105-130.4(t3) and 105-122(c1).

[24] See S557, S.L. 2019-246, §3.(f).

[25] 585 U.S. ___; 138 S. Ct. 2080 (2018).

[26] See Directive SD-18-6.

[27] See S56, S.L. 2019-6, §5.2; N.C. Gen. Stat. §105-164.8(b)(9).

[28] See S81(2017).

[29] See S557, S.L. 2019-246, §4.(a); N.C. Gen. Stat. §105-164.3.

[30] See S557, S.L. 2019-246, §4.(c); N.C. Gen. Stat. §105-164.4J.

[31] See S557, S.L. 2019-246, §4.(c); N.C. Gen. Stat. §105-164.4J(c).



- [32] See S557, S.L. 2019-246, §4.(c); N.C. Gen. Stat. §105-164.4J(f).
- [33] See S557, S.L. 2019-246, §4.(c); N.C. Gen. Stat. §105-164.4J(d).
- [34] See S557, S.L. 2019-246, §4.(c); N.C. Gen. Stat. §105-164.4J(d).
- [35] See S557, S.L. 2019-246, §4.(q).
- [36] See S557, S.L. 2019-246, §4.(d); N.C. Gen. Stat. §105-164.3.
- [37] See S557, S.L. 2019-246, §4.(e); N.C. Gen. Stat. §105-164.4F.
- [38] See S557, S.L. 2019-246, §4.(e); N.C. Gen. Stat. §105-164.4F(b1).
- [39] See S557, S.L. 2019-246, §4.(e); N.C. Gen. Stat. §105-164.4F(c).
- [40] See S557, S.L. 2019-246, §4(e); N.C. Gen. Stat. §105-164.4F(c1).
- [41] See S557, S.L. 2019-246, §4.(q).
- [42] See N.C. Gen. Stat. §105-187.5.
- [43] See H537, S.L. 2019-69; N.C. Gen. Stat. §105-187.5.
- [44] See S523, S.L. 2019-169, §3.1.(b); N.C. Gen. Stat. §105-164.3(2f).
- [45] See S523, S.L. 2019-169, §3.9.(c), (d), (e) and (f); N.C. Gen. Stat. §105-164.4K.
- [46] See S523, S.L. 2019-169, §3.11; N.C. Gen. Stat. §105-164.13(61a)k.
- [47] See S523, S.L. 2019-169, §3.12; N.C. Gen. Stat. §105-164.13(5p).
- [48] See S523, S.L. 2019-169, §3.13; N.C. Gen. Stat. §105-164.13(13d).
- [49] See IRC §118.
- [50] See H399, S.L. 2019-237, §2; N.C. Gen. Stat. §§105-130.5(b)(31) and 105-153.5(b)(14).
- [51] S557 also permanently authorizing the Revenue Laws Study Committee to review any tax provision scheduled to sunset within one year to determine whether the sunset should be extended. See S557, §5.
- [52] See H399, S.L. 2019-237, §3.(a); N.C. Gen. Stat. §105-129.110.
- [53] See H399, S.L. 2019-237, §4.(a); N.C. Gen. Stat. §105-164.13(11b).
- [54] See H399, S.L. 2019-237, §5.(a); N.C. Gen. Stat. §105-164.13(65) and (65a).

[55] See H399, S.L. 2019-237, §5.(b); N.C. Gen. Stat. §105-164.4A(a)(4).

[56] See H399, S.L. 2019-237, §5.(b); N.C. Gen. Stat. §105-164A(a)(5).

[57] See H399, S.L. 2019-237, §3.(b); N.C. Gen. Stat. §§105-129.71 and 105-129.75.

[58] See H492, S.L. 2019-123; N.C. Gen. Stat. §105-105-282.1(a)(2)c.

[59] See H399, S.L. 2019-237, §7.

[60] See S557, S.L. 2019-246, §8.1.

[61] See generally S498, S.L. 2019-187; N.C. Gen. Stat. §§105-114(d), 105-130.1(b), 105-131.7(f), 105-154(c), 105-153.2, 105-153.8(a), 105-163.1(13)105-163.3(b), 105-163.7(b) and 105-449.69A. See also N.C. Gen. Stat. §166A-19.70A

[62] See S523, S.L. 2019-169, §5.1; N.C. Gen. Stat. §105-243.1(d).

[63] See Code §6015(a) and (f).

[64] See S523, S.L. 2019-169, §2.1; N.C. Gen. Stat. §105-153.8(e).

[65] See S523, S.L. 2019-169, §5.3.

[66] See S523, S.L. 2019-169, §6.1; N.C. Gen. Stat. §105-241.6(b).

[67] See S523, S.L. 2019-169, §6.3; N.C. Gen. Stat. §105-228.90(b)(3a).

[68] See S523, S.L. 2019-169, §6.8; N.C. Gen. Stat. §105-236(b).

[69] See S.L. 2018-98.

[70] See H966, §41.3.

[71] See H966. §8A.9.(h) and (j).

[72] See H966, §9D.19.

[73] See H966, §40.14.

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