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PUBLICATIONS & ALERTS

2020 NORTH CAROLINA TAX LEGISLATION

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The North Carolina General Assembly concluded the regular business of its 2020 session on Friday, June 26, 2020. While the session will not formally adjourn until September 3, 2020, the only business expected to be considered between now and then is limited to addressing potential gubernatorial vetoes, handling appointments and appropriating federal pandemic relief funds. Consequently, although the 2020 session will technically continue for more than two months, no further tax legislation is expected.

Two prior Alerts summarized the **tax provisions included in Senate Bill 704**, the General Assembly's COVID-19 response bill, and in the **original version of House Bill 1080**, the session's omnibus tax measure. After several amendments, House Bill 1080 was ratified on June 25, 2020 and presented to the Governor, who is expected to sign it. The General Assembly also enacted a separate sales tax measure and several other bills that included changes to the North Carolina Revenue Act. This Alert updates and supplements our previous Alerts and summarizes the more important tax provisions of all legislation enacted during this session.

Readers should note that the Governor has yet to sign House Bill 1080 and several of the other ratified bills discussed below, and the provisions included in these bills will not become effective unless and until the bills are signed by the Governor or otherwise become law.

Provisions covered in this Alert:

- **Internal Revenue Code Update**
- **Personal Income Tax Changes**
- **Franchise Tax Changes**
- **Corporate Income Tax Changes**
- **Sales Tax Changes**
- **Incentives**
- **Insurance Tax Changes**
- **Property Tax Changes**
- **Motor Fuels Tax Changes**
- **Administrative Changes**
- **COVID-19 Tax Relief**

- **Other Matters**

Internal Revenue Code 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^[1] in order to incorporate some or all of the changes made to the Code during the preceding year. The current Code reference is to the Code in effect on January 1, 2019. House Bill 1080 updates the reference date to May 1, 2020.^[2]

Congress enacted two bills amending the Code between the existing reference date and May 1, 2020: The Taxpayer Certainty and Disaster Relief Act of 2019 (the “TCDRA”), included as Division Q of the Further Consolidated Appropriations Act, 2020,^[3] and the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”).^[4]

One of the changes made by the TCDRA was to reduce the threshold for the deduction of unreimbursed medical expenses from 10% to 7.5% of Adjusted Gross Income for 2019 and 2020. North Carolina will conform to this change. TCDRA also extended a number of expiring federal tax provisions from which North Carolina has historically decoupled: the gross income exclusion for the discharge of qualified principal residence indebtedness, the treatment of mortgage insurance premiums as qualified residence interest and the deduction for qualified tuition and related expenses.^[5] House Bill 1080 decouples from these extended federal provisions through 2020.^[6]

The CARES Act included numerous tax provisions intended to improve the cash position of individuals and businesses in response to the economic shock caused by the COVID-19 pandemic and government lock-down orders. These provisions were summarized in a previous **Alert**. House Bill 1080 decouples from the following CARES Act provisions:

- **Net Business Interest:** The CARES Act increased from 30% to 50% the amount of adjusted taxable income that may be offset by net business interest expense for 2019 and 2020. The bill requires corporate and individual taxpayers to add back the additional interest expense deduction.^[7]
- **Charitable Contribution Percentage Limitations:** North Carolina permits individual taxpayers to claim a charitable contribution deduction equal to the federal deduction allowed under Code section 170. That section imposes percentage limitations on the charitable contribution deduction allowed in any given year, with the excess carried forward to later years. The CARES Act suspended the percentage limitation on charitable contributions made in 2020. House Bill 1080 limits 2020 individual charitable contribution deductions to the pre-CARES Act federal deduction amount.^[8]
- **Net Operating Losses:** The CARES Act eliminated the prohibition on the carryback of net operating losses (“NOLs”) arising in 2018, 2019 and 2020. The CARES Act also suspended the 80% limitation on the amount of taxable income that may be offset by NOLs for 2018, 2019 and 2020. House Bill 1080 decouples from these changes by requiring individual taxpayers to add back the amount of any 2018, 2019 or 2020 NOL (other than farming losses) carried back to a prior year.^[9] The amount added back may be deducted in five equal installments beginning in 2021.^[10] In addition, individual taxpayers must add back the amount of any carryforward deductions for NOLs (other than farming losses) arising in 2018, 2019 or 2020 in excess of the pre-CARES Act 80% limitation.^[11] The amount added back may be

deducted in five equal installments beginning in 2021.[12]

- **Qualified Education Loans:** The CARES Act expanded the gross income exclusion for employer-provided education assistance to cover interest and principal on qualified education loans paid by an employer in 2020. House Bill 1080 requires such qualified education loan payments to be added back to North Carolina income to the extent excluded for federal purposes.[13]
- **Excess Business Losses:** The 2017 Tax Cuts and Jobs Act imposed a limit on the deduction of excess business losses by noncorporate taxpayers. The CARES Act retroactively delayed the application of this limitation until 2021. House Bill 1080 decouples from this provision by requiring individual taxpayers to add back any business losses deducted for federal purposes in 2018, 2019 and 2020 in excess of the amounts that would have been deductible under the pre-CARES Act limits.[14] The amount added back may be deducted in five equal installments beginning in 2021.[15]
- **Charitable Contribution for Nonitemizers:** The CARES Act allowed individual taxpayers a \$300 above-the-line deduction for cash charitable contributions made in 2020. House Bill 1080 requires individual taxpayers to add this deduction back in computing North Carolina income.[16]
- **Paycheck Protection Program Loans:** The CARES Act expanded the Small Business Act to create a small business interruption loan program (the Paycheck Protection Program or “PPP”). PPP loans are intended to help taxpayers make payroll, rent and utility payments during the COVID-19 pandemic. If the loan proceeds are used for these purposes, the CARES Act provides that the loans will be forgiven and the amount forgiven excluded from gross income. The Internal Revenue Service announced in Notice 2020-32 that expenses funded by a forgiven PPP loan may not be deducted. Congress may override the IRS’s position and permit such expenses to be deducted.[17] House Bill 1080 requires both individual and corporate taxpayers to add back the amount of any expenses deducted for federal purposes to the extent funded by a forgiven PPP loan.[18]

Personal Income Tax Changes

Breast and Cervical Cancer Research Donation

In 2017, the General Assembly enacted a temporary provision permitting individuals entitled to a refund of personal income taxes to elect to contribute all or part of the refund to the state Department of Health and Human Services to support early detection of breast and cervical cancer. This provision is set to expire at the end of this year. House Bill 1080 extends the provision through 2025.[19]

Nonresident Pass-Through Business Owners

Under current law, the manager of a pass-through business with one or more nonresident owners or partners must file a composite return reporting the nonresident’s share of the business’s income attributable to North Carolina and must pay the nonresident’s North Carolina income tax on such income. However, the business does not have to pay the nonresident’s North Carolina tax if the nonresident owner or partner is not an individual and the business provides an affirmation signed by the nonresident that it will pay the tax due with its own return. House Bill 1080 clarifies, in accordance with the existing practice of the Department of Revenue (the “Department”), that the affirmation must be provided annually by the due date of the business’s information return.[20] This provision is effective upon enactment.[21]

Franchise Tax Changes

Add-Back for Affiliated Indebtedness

Under current law, the net worth franchise tax base is subject to an adjustment for affiliated indebtedness. Specifically, a corporation must add back to its net worth base any indebtedness owed to a “parent, subsidiary, an affiliate or a noncorporate entity in which the corporation or any affiliated group of corporations owns more than 50% of the capital interests,” except to the extent that the affiliated indebtedness is attributable to capital borrowed by the creditor from unrelated parties.^[22] For income tax purposes, current law provides that a corporation may deduct interest expense paid to a “related member” only to the extent it constitutes “qualified interest expense,” i.e., only to the extent it is proportional to the amount of interest paid by the related member to an unrelated lender.^[23]

House Bill 1080 amends the franchise tax adjustment to make it consistent with the income tax adjustment. That is, the franchise tax net worth base add-back will be equal to the amount of indebtedness that creates interest expense that is required to be added back for income tax purposes.^[24] This change is effective with the 2021 franchise tax year reported on 2020 income tax returns.^[25] This change arguably could require a larger or smaller adjustment to net worth than current law to the extent the income tax definition of “related member” differs from the existing franchise tax concept of parent, subsidiary, affiliate or controlled noncorporate entity.

Corporate Income Tax Changes

Transactions Among Affiliates

Intercompany transactions were the source of much litigation a number of years ago. As a result, the General Assembly enacted section 105-130.5A to clarify the Secretary’s powers to make adjustments to intercompany transactions and to require the filing of a combined return.

When the Secretary requires adjustments to an intercompany transaction, those adjustments will usually result in increasing the income of one affiliate and reducing the income of the other, producing an assessment against one affiliate and a refund opportunity for the other. House Bill 1080 provides that in such a case the refund may not be made until the corresponding assessment has become collectible and that the amount of the refund, when made, must reflect “any changes made by the Department under this section.” ^[26]

The idea behind these changes is to prevent a situation where (i) the Department makes an adjustment to an intercompany transaction that produces a refund for one party and an assessment for another, (ii) the party entitled to the refund accepts it and the refund is paid, (iii) the party subject to the assessment fights the assessment and then succeeds in getting it reduced through an administrative settlement or proceedings at the Office of Administrative Hearings. In that case, the Department will have paid a refund to one party based on a proposed assessment to the other party that is larger than what is ultimately determined to be due. By this point the statute might have run on the Department’s ability to recover the overpaid refund.

Sales Tax Changes

Nonprofit and Governmental Entity Refunds for Digital Property Purchases

Under current law, nonprofit and governmental entities may apply for refunds of state and local sales taxes paid on purchases of tangible personal property and services.[27] House Bill 1080 expands this provision to permit these taxpayers also to obtain refunds of state and local taxes paid on certain digital property, applicable to purchases made on or after July 1, 2020.[28]

Sales Subject to Use Tax

Current law provides that individual taxpayers must file returns and pay use taxes on items purchased “outside the State.”[29] After the Supreme Court’s decision in *South Dakota v. Wayfair, Inc.*[30], the tax on many out-of-state purchases will be collected by requiring the seller to collect the use tax and such transactions will not be required to be reported by the purchaser. Accordingly, House Bill 1080 eliminates as obsolete the reference to purchases “outside the State.”[31]

Marketplace Facilitators

Last year, the General Assembly passed legislation requiring marketplace facilitators to collect tax on facilitated sales if the facilitator exceeded an economic nexus threshold of \$100,000 in in-state sales or 200 transactions directed into the state.[32] House Bill 1080 makes two changes with respect to marketplace facilitators.

- Change to Nexus Standard: The bill replaces the \$100,000/200 transaction threshold requirement with a requirement that the facilitator be “engaged in business” in North Carolina.[33] The purpose of this change is apparently to ensure that facilitators who have a physical presence in the state collect sales taxes on sales to North Carolina purchasers even if they do not satisfy the economic nexus threshold. The change also has the effect of eliminating any statutory safe harbor for facilitators who lack a physical presence in the state. This change applies to sales made on or after July 1, 2020.[34]
- Local Meals Tax: The bill requires marketplace facilitators (such as Grub Hub) that are required to collect the state sales tax on facilitated sales of prepared food and beverages also to collect any applicable local meals tax on such sales.[35] This change is effective for sales occurring on or after July 1, 2020.[36] Currently, the only localities that have enacted meals taxes are Cumberland, Dare, Mecklenburg and Wake Counties and the Town of Hillsborough.

Livestock Purchases by Qualifying Farmers

House Bill 1079,[37] entitled *Various Sales Tax Changes*, included a number of sales tax changes recommended by the Revenue Laws Study Committee. The bill was ratified by the General Assembly on June 1, 2020 and signed by the Governor on June 5, 2020.

One change made by House Bill 1079 was to broaden a sales tax exemption for qualifying farmers. Under prior law, qualifying farmers could purchase baby chicks and poults free of tax under an exemption certificate if they were purchased for commercial poultry or egg production. The bill broadened this exemption to cover purchases of livestock, defined as cattle, sheep, goats, swine, horses and mules.[38] The bill also eliminated (presumably as redundant) the limitation that the exemption for baby chicks and poults applied only to purchases for commercial poultry and egg production. These changes are effective for sales occurring on or after July 1, 2020.[39]

Sales by Auctioneers

House Bill 1079 makes several clarifying changes regarding the liability of auctioneers to collect sales tax. Auctioneers who sell property that they purchased or took on consignment have long been required to register and collect sales tax. However, in the 1990s the Department had issued guidance that an auctioneer was not required to collect sales tax when it sold tangible personal property for the owner at the owner's location. This interpretation applied to estate sales conducted at an owner's premises, including livestock auctions conducted at the seller's farm, and to on-site sales of fixtures and equipment belonging to merchants going out of business. The theory behind this interpretation was that the auctioneer was acting as an agent for the owner of the property and so was entitled to the benefit of the casual sale exemption to which the owner would have been entitled if it made the sale itself. Last year's enactment of legislation requiring marketplace facilitators to collect tax on facilitated sales changed this result for any auctioneer that met the definition of a marketplace facilitator, regardless of where the auction was held. The application of the marketplace facilitator rules to auctioneers led to confusion in the auction industry. House Bill 1079 therefore provides two relief provisions for auctioneers:

- **Tag Sales, Estate Sales and Going-Out-of-Business Sales by Auctioneers:** House Bill 1079 provides that the Department may not assess taxes with respect to periods beginning on or after February 1 and ending before October 1, 2020 with respect to businesses that conduct tag sales or estate sales at either a person's home or farm and to auctions of fixtures and equipment that were held for use by a retail or wholesale business when the sale is conducted at the business location. This grace period does not apply to taxpayers who received written advice from the Department covering the transactions at issue, to persons who collected but failed to remit the tax due or to retail sales of inventory.^[40]
- **Livestock Sales by Auctioneers:** A farmer is entitled to a sales tax exemption on sales of farm products, including livestock.^[41] An auctioneer selling livestock on behalf of the farmer, however, is not entitled to the benefit of this exemption. Because of confusion over this issue, House Bill 1079 authorizes the Secretary to compromise the liability of an auctioneer with respect to the sale of livestock at auction for which the auctioneer failed to collect sales tax if the auctioneer can demonstrate a good faith effort to comply with the tax laws. A showing of good faith includes being registered as a retailer by July 1, 2020. This relief provision applies only to tax due for reporting periods ending before July 1, 2020 and does not apply if the taxpayer had received written advice from the Department regarding the transactions at issue or collected but failed to remit the tax due.^[42]

Large Fulfillment Facility Exemption Expansion

In 2017, the General Assembly enacted a sales and use tax exemption for certain equipment purchased by a "large fulfillment facility," defined as a facility used primarily for receiving, inventorying, sorting, repackaging and distributing finished retail products for the purpose of fulfilling customer orders. To be eligible for the exemption, the Department of Commerce must have certified that an investment of at least \$100 million would be made in the facility within five years and that the facility would employ 400 people. House Bill 1079 expands the large fulfillment facility exemption to cover equipment used (i) to bale previously used packaging for resale, (ii) to sanitize in accordance with federal requirements and (iii) to handle materials. In addition, the exemption is expanded to cover items purchased by a contractor or subcontractor if the purchase is for use in the performance of a contract with the large fulfillment facility.^[43] These expansions of the exemption were intended to make it available to the Publix grocery store chain, which is building a distribution center in Greensboro.

These provisions are effective for sales occurring on or after July 1, 2020.^[44] However, the bill provides that a large fulfillment facility that made purchases, directly or through contractors or subcontractors, of equipment covered by the exemption (as expanded by the bill) between April 1 and July 1 of 2020 may obtain a refund of taxes paid on such purchases by filing a refund request before October 1, 2020.^[45]

Digital Property Provisions

House Bills 1079 and 1080 made a number of changes regarding the sales taxation of digital property.

- **Digital Code:** House Bill 1080 provides that the sales and use tax on “certain digital property” also applies to digital code. Thus, the sale or use of digital code is taxable to the same extent as the sale or use of certain digital property to which the code relates.^[46] This change is effective upon enactment.^[47]
- **Educational Services:** Last year the General Assembly revised the definition of “certain digital property” to eliminate any suggestion that the only digital property that was subject to tax was digital property that had a tangible counterpart.^[48] This change led UNC to inquire whether the provision of online education was taxable, since the revised definition of “certain digital property” would cover live-streamed and pre-recorded videos of online classes and presentations. House Bill 1079 addresses this concern by further revising the definition of “certain digital property” to exclude a digitally-delivered “education service.”^[49] An education service is defined as the delivery of instruction or training in real time, on demand or as a scheduled replay by or on behalf of a “qualifying educational entity,” if the service satisfies one of a list of conditions.^[50] A “qualifying educational entity” is defined to include public and private K-12 schools and institutions of higher education (including public and private universities and colleges, community colleges and certain vocational programs). The term does not include for-profit or non-profit providers of professional continuing education. However, the bill prohibits the Department from assessing tax due for periods beginning on or after October 1, 2019 and ending before August 1, 2020 with respect to sales of digital audio works or digital audiovisual works that (i) consist of continuing education instruction approved or required by an occupational licensing board or (ii) consists of professional development instruction for school board members, administrators or staff. This relief is not available for taxpayers who received written advice from the Department covering the transactions at issue or who collected but failed to remit the tax due.^[51]
- **Home School Digital Materials:** House Bill 1079 also creates an exemption for sales of audio works or audiovisual works to operators of home schools if the work is a qualifying educational expense.^[52]
- **Digital Content Provided Simultaneously with Live Events:** Finally, House Bill 1079 creates an exemption for sales of digital audio works or digital audiovisual works that consist of nontaxable service content when the transfer occurs contemporaneously and in real-time with the provision of the nontaxable service.^[53] Examples would include an exercise class, a music lesson or a financial planning seminar live-streamed via Zoom. This exemption is required by the federal Internet Tax Freedom Act,^[54] which prohibits the states from imposing discriminatory taxes on digital goods and services. Since a live, in-person exercise class is a nontaxable service, the state is prohibited from taxing the same content delivered live over the Internet. However, because a video or audio recording of the same content is considered distinct from the live performance, it is not treated as entitled to the protections of the federal law. Thus, pre-recorded or on-demand webinars would be taxable.

The digital property changes made by House Bill 1079 are effective retroactively to sales occurring on or after October 1, 2019, the effective date of the 2019 change to the definition of certain digital property.^[55]

Incentives

The state's Jobs Development Investment Grant Program was scheduled to sunset on January 1, 2021. House Bill 1080 extends the sunset until January 1, 2030.^[56]

Insurance Tax Changes

Regulatory Charge

The insurance regulatory charge is an annual fee imposed on insurance companies to reimburse the state for the costs of regulating the industry. The fee is expressed as a percentage of an insurance company's gross premiums tax liability. The rate is established by the General Assembly each year based on recommendations from the Department of Insurance. The rate has been 6.5% since 2015. House Bill 1080 sets the rate at 6.5% by statute. As a result, the legislature will not need to set the rate each year, and the rate will remain at 6.5% until the Department of Insurance recommends a change.^[57]

Prepaid Health Plans

Senate Bill 808, an omnibus health care measure, was ratified by the General Assembly on June 26th and presented to the Governor, who had not acted on the bill as of the date of this Alert. The bill would subject prepaid health plans to the insurance company gross premiums tax (at the rate of 1.9%) and the insurance regulatory charge. The base on which the gross premiums tax would be applied would include a prepaid health plan's capitation payments, defined as amounts received from the Department of Health and Human Services for the delivery of Medicaid and NC Health Choice services. Capitation payments refunded to the state would be allowed as a deduction.^[58] These changes would become effective 30 days after the bill becomes law and would apply to capitation payments received after that date.^[59]

Property Tax Changes

Present-use Valuation

Senate Bill 315,^[60] the annual farm bill, was ratified on June 8th and signed by the Governor on June 12th. The bill includes a change to the present-use valuation program for agricultural land, horticultural land and forestland. Specifically, the bill provides that, if a county assessor determines that a property has lost its eligibility for present-use value classification (other than because of a failure to file an application following a transfer of the property), the assessor must provide the taxpayer a written notice of his decision. The taxpayer may appeal the decision within 60 days after the date of the written notice. However, the taxpayer would not be required to file appeals for subsequent tax years while the original appeal is outstanding. If the taxpayer's appeal is successful, the property's present-use value classification would be reinstated retroactive to the date the classification was revoked. If, while the appeal is pending, the assessor determines that the property ceases to qualify for present-use value classification because of some other disqualifying event, the assessor must provide a new written notice to the taxpayer.^[61] This provision is effective Jun 8, 2020.^[62] For an example of the kind of situation this amendment was designed to avoid, see the North Carolina Court of Appeals decision in *Miller v. Graham*

County.^[63]

Property Tax Liens for SUTA Contributions

The Division of Employment Security can collect a delinquent SUTA contribution from an employer by placing a lien on the employer's property. The priority of liens, including tax liens, generally is determined by when the liens were recorded. A special rule, however, provides that property tax liens on real property take priority over previously recorded liens except for previously recorded liens for "state taxes."^[64] Senate Bill 704, the COVID-19 Recovery Act, which the Governor signed on May 4, 2020, clarifies that SUTA contributions are "state taxes." As a result, property tax liens on real property do not take priority over previously filed liens for delinquent SUTA contributions.^[65]

Motor Fuels Tax Changes

House Bill 77, the annual Department of Transportation bill, was ratified and presented to the Governor on June 25, 2020. As of the date of this Alert, the Governor has taken no action on the bill. The bill provides a minimum motor fuel excise tax rate for 2021. The motor fuel excise tax rate is generally calculated by multiplying the rate in effect during the previous year by a percentage determined by reference to changes in the state's population and the rate of inflation. The bill provides that, notwithstanding this statutory formula, the rate for 2021 would not be less than \$0.361 per gallon.^[66]

Administrative Changes

Power of Attorney Database

In 2019, the General Assembly directed the Department to update its electronic systems to store and recognize power of attorney registrations. This was intended to ensure that notices to taxpayers were simultaneously sent to taxpayer representatives.^[67] House Bill 1080 authorizes the Department to use up to \$500,000 of collection assistance fees generated in the 2020-2021 fiscal year to implement this project.^[68]

Confidentiality of Tax Information

The Secretary is authorized to assign the responsibility and jurisdiction to enforce certain criminal tax provisions to employees of the Department's Tax Enforcement Division. House Bill 1080 expands the list of these criminal tax provisions to include violations by state officials of the duty to maintain the confidentiality of tax information, which are Class I misdemeanors.^[69]

Trust Fund Taxes

House Bill 1080 makes two trust fund tax changes.

- **Statute of Limitations:** Under current law, where a taxpayer collects but fails to remit sales taxes, withheld income taxes or other trust fund taxes, the Department must assess the tax within the normal three-year limitation period unless it can prove a fraudulent intent to evade tax, in which case no statute of limitation applies. Because fraud can be difficult to prove, the bill provides that the period for proposing an assessment of trust fund taxes will not expire until ten years after the later of the date the return was due or the date the return was filed. This change is effective upon enactment and applies to assessments not

barred by the current statute of limitations at that time.^[70] A previous version of the bill would have eliminated the statute of limitations on assessments of trust fund taxes.

- **Criminal Liability:** The bill provides that a person's status as a responsible person or not, and therefore his potential civil liability for trust fund taxes, has no bearing on his potential criminal tax liability.^[71] This change is intended to prevent persons charged with crimes such as abetting the embezzlement of sales taxes but who are not responsible persons from avoiding criminal liability.^[72]

Overdue Tax Debts

Current law authorizes the Department to impose a 20% collection assistance fee on any tax debt that remains unpaid 90 days after it becomes collectible. House Bill 1080 shortens this period to 60 days. The change is effective August 1, 2020 and applies to tax debts that become collectible on or after that date.^[73]

Identification Numbers

House Bill 1080 requires taxpayers to include their full taxpayer identification numbers (as opposed to truncated numbers such as the last four digits of a Social Security number) on all filings with the Department unless specifically authorized to do otherwise.^[74] This change is effective upon enactment.

Taxpayer Conferences

Under current law, taxpayers are entitled to a conference with the Department after filing an objection to a proposed assessment or a proposed denial of a refund. House Bill 1080 clarifies that the taxpayer and the Department may reschedule a conference by mutual agreement.^[75]

Current law also provides that, if a taxpayer fails to attend a scheduled conference without prior notice to the Department, the parties are deemed to be unable to resolve their differences and the Department must issue a Notice of Final Determination. House Bill 1080 eliminates the reference to the absence of prior notification to the Department. As a result, the Department is authorized to issue a Notice of Final Determination if a taxpayer is unable to attend a scheduled conference even if the taxpayer had given prior notice to the Department.^[76]

COVID-19 Tax Relief

Senate Bill 704, the COVID-19 Recovery Act, was ratified on May 2, 2020 and signed by the Governor on May 4, 2020. The bill included important pandemic-related tax relief provisions.

Interest Waiver

In March, the Department exercised its authority under section 105-263(b) of the General Statutes to extend the 2020 due date for filing income and franchise tax returns. Returns originally due April 15, 2020 were extended until July 15, 2020. This extension applied to returns due from individuals, corporations, partnerships, trusts and estates.^[77] The Department also previously exercised its authority under section 105-237 to waive failure to pay penalties for income and franchise taxpayers as long as they paid taxes otherwise due on April 15, 2020 by July 15, 2020.^[78]

However, the Department explained in the penalty waiver Notice that it lacked statutory authority to waive interest. As a result, even though income and franchise taxpayers were granted extensions until July 15, 2020 to file returns and pay taxes, they would still be required to pay interest on the amounts deferred from the original due date of their returns until the date of payment.

On March 31, 2020, the Department expanded its filing and penalty relief to cover sales taxes, withholding taxes and various excise taxes. Under the expanded relief, returns and taxes due during the period from March 15, 2020 through July 15, 2020, would be considered timely filed and paid if the required action was taken by July 15, 2020.^[79]

Senate Bill 704 directed the Department to waive the accrual of interest on any income or franchise tax return for the period from April 15, 2020 through July 15, 2020. This relief applies to returns filed by individuals, corporations, partnerships, estates and trusts.^[80] The interest relief specifically applies to first and second quarter estimated tax payments but does not apply to interest on taxes reported on returns that were due before April 15, 2020 or to interest on taxes reported on returns required to be filed on or before July 15, 2020 that are filed after that date.

Notably, the law does not waive the accrual of interest on other taxes, such as sales taxes, for which the Department provided penalty relief in its March 31, 2020 Notice.

Extended Deadline for 2016 Refund Claims

Senate Bill 704 also extended the dates for filing certain refund claims. Any claim for a refund of income or franchise taxes, which, under the statute of limitations, would otherwise be due between April 15, 2020 and July 15, 2020, is considered timely if filed by July 15, 2020.^[81] Refund claims are generally required to be filed within three years from the date the return was due. Thus, taxpayers wishing to claim a refund of 2016 taxes reported on returns filed on April 15, 2017, and which would otherwise have been due on April 15, 2020, have until July 15, 2020 to file the claim.

Extended Deadlines for Tax Appeals

Senate Bill 704 also extended the deadlines for taking certain actions in connection with tax appeal proceedings. The actions covered are: (i) Requests for DEPARTMENT review of proposed assessments or proposed refund denials, (ii) contested case petitions before the Office of Administrative Hearings (OAH) challenging a notice of final determination and (iii) requests for judicial review of OAH decisions. Any of these filings that are otherwise required to be made on or after April 1, 2020 and before July 15, 2020 are considered timely if filed by July 15, 2020.^[82] These extensions apply to contests involving any tax subject to the uniform tax appeal procedures and not just to income and franchise taxes.

SUTA Contribution Credit

Senate Bill 704 also made changes to the state's unemployment insurance program and the State Unemployment Tax Act ("SUTA") that provides funding for the program. While most of these changes are beyond the scope of this Alert,^[83] they include a SUTA tax credit for employers equal to the amount of the unemployment insurance contributions payable on the SUTA report due on April 30, 2020. If the employer has already remitted the contributions shown on the report, the credit is applied against the contribution due with the report due on July 31, 2020, and any excess credit will be refunded to the employer. An employer must file a

return to receive the credit.[84]

Motor Vehicle Tax Extension

Senate Bill 704 requires the Division of Motor Vehicles to extend the validity of vehicle registrations and certain other credentials that would otherwise expire between March 1, 2020 and August 1, 2020 for five months. The bill also extends the due date for the payment of any motor vehicle tax that is tied to registration expiration so as to correspond with the extended expiration date.[85]

Other Matters

In addition to the matters discussed above, legislation enacted in 2020 (i) made changes to the Tobacco Products Tax, the Motor Fuels Tax and the Severance Tax,[86] (ii) made technical changes to the apportionment method applicable to national broadcasters,[87] (iii) repealed obsolete corporate and personal income tax adjustments related to the state's decision to decouple from a 2009 federal change allowing taxpayers to defer recognition of certain cancellation of indebtedness income,[88] (iv) repealed an obsolete adjustment to the federal definition of unrelated business income,[89] (v) corrected a statutory reference in a provision governing S corporation tax credits,[90] (vi) exempted the Department from certain requirements imposed on state agencies that issue licenses,[91] (vii) extended until July 1, 2025, the sunset on the ability of North Carolina cities to use special assessment districts to finance infrastructure needs,[92] and (viii) extended until July 1, 2026 the sunset on the ability of natural gas local distribution companies to recover certain infrastructure costs through rate increases.[93]

One measure that was not enacted during the session was Senate Bill 848. The original version of that bill would have provided a total of \$50 million in franchise tax credits in each of 2020 and 2021 to taxpayers who made investments or retained workforce during those years. A later version of the bill converted the credit into a grant program available to franchise taxpayers that increased their investments in property in North Carolina. It is possible that some version of this bill may be revived in September when the General Assembly considers appropriations of any available federal pandemic relief funds.

Conclusion

For more information about 2020 North Carolina tax legislation, please contact a member of Smith Anderson's **Tax Group**, business lawyers who understand taxation.

[1] Chapter 105 of the North Carolina General Statutes.

[2] H1080, §1.(a); N.C. Gen. Stat. §105-228.90(b)(1b).

[3] P.L. 116-94.

[4] P.L. 116-136.

[5] See P.L. 116-94, Division Q, §§101, 102 and 104.

- [6] H1080, §1.(e) and 1.(f); N.C. Gen. Stat. §§105-153.5(a)(2)b and 105-153.5(c2)(1) and (2).
- [7] H1080, §§1.(c) and 1.(f); N.C. Gen. Stat. §105-130.5(a)(31) and 105-153.5(c2)(17).
- [8] H1080, §1.(d); N.C. Gen. Stat. §105-153.5(a)(2)a.
- [9] H1080, §1.(f); N.C. Gen. Stat. §§105-153.5(c2)(8), (9) and (10). The addback requirement also applies to unabsorbed 2018, 2019 or 2020 NOL carrybacks that are carried forward to later carryback years. See H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(11).
- [10] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(14).
- [11] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(13).
- [12] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(16).
- [13] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(18).
- [14] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(12).
- [15] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(15).
- [16] H1080, §1.(f); N.C. Gen. Stat. §105-153.5(c2)(19).
- [17] See Senate Bill 3612, which was introduced in Congress on May 5, 2020.
- [18] H1080, §1.(c) and (f); N.C. Gen. Stat. §§105-130.5(a)(32) and 105-153.5(c2)(20).
- [19] H.1080, §7.1; N.C. Gen. Stat. §105-269.8(c).
- [20] H1080, §4.3; N.C. Gen. Stat. §105-154(d).
- [21] H1080, §10.
- [22] See N.C. Gen. Stat. §105-122(b)(2).
- [23] See N. C Gen. Stat. §105-130.7B.
- [24] H1080, §5.1.
- [25] H1080, §5.1.(b).
- [26] H1080, §5.4; N.C. Gen. Stat. §105-130A(k).
- [27] See N.C. Gen. Stat. §§105-164.14(b) and (c).
- [28] H1080, §3.1.



[29] N.C. Gen. Stat. §105-164.16(d).

[30] 585 U.S. ___, 138 S. Ct. 2080 (2018).

[31] H1080, §3.2.

[32] See N.C. Gen. Stat. §105-164.4J.

[33] H1080, §3.3.(a).

[34] H1080, §3.3.(b).

[35] H1080, §3.5; N.C. Gen. Stat. §§153A-154.1 and 160A-214.1.

[36] H1080, §3.5.(c).

[37] S.L. 2020-6.

[38] H1079, §1; N.C. Gen. Stat. §§105-164.13E(a)(7) and 105-164.3.

[39] H1079, §1.(e).

[40] H1079, §1.(d).

[41] N.C. Gen. Stat. §105-164.13(4b).

[42] H1079, §1.(c).

[43] H1079, §2.(a).

[44] H1079, §2.(c).

[45] H1079, §2.(b).

[46] H1080, §3.4; N.C. Gen. Stat. §105-164.4(a)(1).

[47] H1080, §10.

[48] See S.L. 2019-169, §3.1.(b).

[49] H1079, §3.(a); N.C. Gen. Stat. §105-164.3(23).

[50] H1079, §3.(a); N.C. Gen. Stat. §105-164.3(58).

[51] H1079, §3.(d); N.C. Gen. Stat. §105-244A.

[52] H1079, §3.(b); N.C. Gen. Stat. §105-164.13(72). For the definition of a “qualifying education expense” see N.C. Gen. Stat. §115C-595(a)(3).



[53] H1079, §3.(b); N.C. Gen. Stat. §105-164.13(73).

[54] P.L. 105-277.

[55] H1079, §3.(e).

[56] H1080, §7.4; N.C. Gen. Stat. §143B-437.62.

[57] H1080, §8; N.C. Gen. Stat. 58-6-25(b).

[58] S808, §§16.(b), (c) and (d); N.C. Gen. Stat. §§105-228.3(2) and (6), 105-228.5 and 58-6-25.

[59] S808, §16.(f).

[60] S.L. 2020-18.

[61] S315, §8; N.C. Gen. Stat. §105-277.4(b1).

[62] S315, §16.(b).

[63] 17 CVS 153 (November 19, 2019).

[64] See N.C. Gen. Stat. §105-356(a).

[65] S.L. 2020-3, §1.4.(b).

[66] See H77, §4.2.

[67] S.L. 2019-246, §8.1.

[68] H1080, §6.6.

[69] H1080, §6.1; N.C. Gen. Stat. §105-236.1(a)(3).

[70] H1080, §6.2; N.C. Gen. Stat. §105-241.8(b)(2a).

[71] H1080, §6.3; N.C. Gen. Stat. §105-242.2.

[72] See *General Assembly Legislative Analysis Division, Analysis of 2019-BAxfz-22A* (May 13, 2020), at 8-9.

[73] H1080, §6.4; N.C. Gen. Stat. §105-243.1(d). The statute also requires the Department to mail a notice to the taxpayer stating that the collection assistance fee will be imposed. In 2019, the General Assembly amended this section to permit the Department to mail the notice 60 days (rather than just 30 days) before the date the fee could be imposed. See S523, S.L. 2019-169, §5.1. H1080 also amends the effective date of the 2019 change to conform to the August 1, 2020 date of the current bill. Thus, the Department can include the fee notice in the collection notice.

[74] H1080, §4.4; N.C. Gen. Stat. §§105-163.1(12a), 105-228.90(b)(9) and (10) and 105-252.1.

[75] H1080, §4.5; N.C. Gen. Stat. §105-241.13(b).

[76] H1080, §4.5; N.C. Gen. Stat. §§105-241.13(b) and (c). The summary of the bill prepared by the General Assembly's Legislative Analysis Division states that this change "does not make a substantive difference." See *General Assembly Legislative Analysis Division, Analysis of 2019-BAXfz-22A* (May 13, 2020), at 7.

[77] See *Important Notice: [Department of Revenue Extends the Time to File Income and Franchise Tax Returns to July 15, 2020](#)* (March 23, 2020).

[78] See *Important Notice: [Department of Revenue Provides Special Penalty Relief](#)* (March 19, 2020).

[79] See *Important Notice: [Department of Revenue Expands Penalty Relief for Taxpayers Affected by Coronavirus Disease 2019 \(COVID-19\)](#)* (March 31, 2020).

[80] S.L. 2020-3, §1.1.(a).

[81] S.L. 2020-3, §1.1.(b).

[82] S.L. 2020-3, §1.1.(c).

[83] These changes include provisions to ensure the program is administered flexibly, as encouraged by Congress under the *Families First Coronavirus Response Act*, and changes recommended by the Joint Legislative Oversight Committee on Unemployment Insurance.

[84] S704, §1.2.(a).

[85] S704, §4.7.(e).

[86] H1080, §§2.1 through 2.13.

[87] H1080, §5.2.

[88] H1080, §§4.2 and 5.3.

[89] H1080, §5.5. Specifically, the 2017 Tax Cuts and Jobs Act required tax exempt organizations to increase their unrelated business taxable income by any amount paid or incurred by the exempt organization for qualified transportation fringe benefits, qualified parking or on-site athletic facilities. The 2018 Appropriations Act decoupled from this federal change as it related to parking facilities, such that, for North Carolina purposes, unrelated business taxable income would not include any amount paid or incurred for a parking facility that otherwise would have been taxable under the new federal law. Section 302 of Division Q of the federal Further Consolidated Appropriations Act, 2020 (P.L. 116-94)) repealed the TCJA provision retroactively, and the North Carolina adjustment is therefore no longer required.

[90] H1080, §4.1, correcting a reference in N.C. Gen. Stat. §105-131.8 to N.C. Gen. Stat. §105-151, which was recodified in 2013 as N.C. Gen. Stat. §105-153.9.

[91] H1080, §6.5.

[92] H1080, §7.2.

[93] H1080, §7.3.

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