

Questions for the NCACPA Committee on Taxation Annual

Meeting with the NC Department of Revenue (NCDOR)

December 1, 2015

A. Taxes

	1.	For the privilege tax on mill machinery, there seems to still be confusion over what is considered an article for purposes of the \$80 maximum. I consistently see taxpayers using different approaches and have seen auditors approve various approaches. Below are a few examples of some of these issues:
Eric Wayne	a.	For example, if a manufacturer makes a bulk order of a chemical, is that one article or several articles? Does it matter if the chemicals are delivered in totes versus delivered via tanker truck and pumped into a storage tank? In other words, is each tote an item versus the entire tanker bad being considered an item? For purposes of the 1% rate of tax, the Department does not consider the purchase of chemicals in a tote, tanker, or otherwise to be the purchase of a single "article." As such, the \$80.00 maximum tax does not apply to the purchase of chemicals but rather the 1% rate of tax with no max applies. Sales and Use Tax Technical Bulletin Section 58-15, states, in part, "[p]urchases of chemicals by manufacturing industries and plants for use in water for boilers to prevent corrosion . . . are subject to the 1% privilege tax. " There are other references to application of the 1% rate of tax to purchases of certain chemicals for use by manufacturing industries and plants throughout the technical bulletins as well and such do not provide or qualify that the \$80.00 maximum tax applies to the purchase of these chemicals.
Eric Wayne	b.	Purchases of quantities of piping to use in a manufacturing facility. A taxpayer may purchase many pipe sections, couplings, tees, etc. in order to build a pipeline between two pieces of equipment. Is each length of pipe an item or can the entire purchase be considered one item since it will become one unit ultimately? The purchase of each piece of pipe is the purchase of a single article. If the purchase price of a single piece of pipe exceeds \$8,000, the records (invoice, etc.) clearly demonstrate such, and the pipe is for use in "production" as defined in Sales and Use Tax Technical Bulletin Section 57-A. 1., the 1% rate of tax with a maximum tax of \$80.00 applies to the purchase of each piece of pipe for use in a production activity.
Eric Wayne	c.	Certain businesses use a large volume of items in the production of their products. A pharmaceutical manufacturer may use thousands of pipettes and purchase them in large quantities. Obviously, the pipettes are individual, but they will end up becoming a part of a single piece of equipment. How are the pipettes treated? There are a number of manufacturers that purchase items pursuant to a direct pay permit number issued by the Secretary. G.S. 105-164.27(a) provides, in part, "[a] general direct pay permit authorizes its holder to purchase any tangible personal property, digital property, or service without paying tax to the seller and authorizes the seller to not collect any tax on a sale to the permit holder. A person who purchases an item under a direct pay permit issued under this subsection is liable for use tax due on the purchase. The tax is payable when the property is placed in use or the service is received." The purchase price of the "pipettes" that become a part of a single piece of equipment is subject to tax at the applicable rate to the equipment.
Eric Wayne	2.	With the changes in the taxation of real property services and service contracts related to tangible personal property, is the Department planning on issuing guidance to help taxpayers distinguish between tangible personal property and real property? Can you explain the current rationale being used by the Department of Revenue?

	<p>The Department plans to issue additional guidance in the first part of 2016 regarding the application of sales and use tax to repair, maintenance and installation services subject to tax for sales on or after March 1, 2016. Also, effective March 1, 2016 the exception that provided that a service contract entered into after tangible personal property becomes a part of or attached to real property was not subject to tax is repealed. Thus, effective March 1, 2016, sales of service contracts for such items are subject to tax including any renewals for items on or after that date.</p> <p>The Department will primarily look to the definitions of “service contract”, “real property contractor”, “retailer”, and “repair, maintenance, and installation services”, in administering sales and use taxes on transactions involving tangible personal property that may or may not be attached to or become a part of real property.</p>
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B. Enforcement		
Lennie Collins	1.	<p>What percentage of individual returns report an amount for "consumer use tax"? 2.7% What is the range of amounts reported? The range was from \$1 to \$22,618. How much total consumer use tax is collected each year with individual tax returns? \$6,181,709</p> <p>(The above information is data gathered from 2013 tax return data)</p>
Alan Woodard	2.	<p>A practitioner reports he has a client who owns property in North Topsail Beach but is a resident of Florida. For two years running, this taxpayer has received a nexus type questionnaire from the NCDOR. This taxpayer has also received assessments of NC tax based on information in his federal tax return. What is the source of information that generated these assessments? In order to provide a more responsive answer to the question, we would require the specific set of facts related to this taxpayer. However, instead of receiving a nexus questionnaire for business activity, it is possible the taxpayer received a letter requesting information regarding residency, dependent upon the return falling within one of our selection criteria or refund scoring initiatives. It is important to note, however, any information the NCDOR receives from our exchange agreement with the Internal Revenue Service includes a specific tax return and/or income source that includes a North Carolina address. Our selection criterion and thresholds removes taxpayers from the population that reflects to the NCDOR a high degree of confidence the taxpayer does not have a North Carolina filing requirement. In this scenario, it is possible the taxpayer received rental income from a North Carolina source, or realized a net gain from the sale of property located in North Carolina or had a W-2 issued using a North Carolina address. We would be happy to review the specific facts of this case for your member's client and communicate with the taxpayer or their representative with an executed Power of Attorney.</p>
Alan Woodard	3.	<p>A practitioner submitted the following: NC issued notice to taxpayer assessing tax because of a NC address when no evidence of any NC income. For instance, a young adult who lives/works out of state but uses their parents NC address as a permanent mailing address until they are settled in their careers. We get this type of notice very frequently. How can this situation be prevented?</p>

		<p>In order to provide a more responsive answer to the question, we would require the specific set of facts related to this taxpayer. However, based on your question, this taxpayer may have received a Notice of Intent to Assess from our IRMF initiative or a Notice of Proposed Assessment from our IRTF initiative. Both of these initiatives have multiple criterion and thresholds established to remove any individual from the population that reflects to the NCDOR a high degree of confidence the taxpayer did not have a North Carolina filing requirement. We do not receive any information from the IRS regarding the IRTF and IRMF extracts that does not include an income source or a Federal Return with a North Carolina address as the base. There is a North Carolina income source document or a Federal Return with a North Carolina address associated with anyone receiving a Notice of Intent or Notice of Proposed Assessment from these two initiatives. So, typically in cases involving a recent college graduate, interest income or dividend income has a North Carolina address, and may be the individual's parent's address. Also, generally, the individual may still have an active North Carolina driver's license. Therefore, a Notice of Intent to Assess or Notice of Proposed Assessment was sent to the address of record. An individual may remain a North Carolina resident and only work temporarily out of state which would require a North Carolina return filing providing credit to tax paid to another state. If the individual does, in fact, have no filing requirement and has moved their residency to another state, we hope this process is streamlined for the taxpayer and/or their representative. A short conversation followed by a few documents, will generally resolve the issue. If the taxpayer's representative wishes to provide us with the name of the taxpayer, we will review our records to determine if we have any errors in our criterion or thresholds that need to be addressed.</p>
Alan Woodard	4.	<p>What is the volume of audits of 1099 and the required withholding on independent contractors with ITINs? What has been found in terms of compliance, underpaid withholding, etc. From January 1, 2015 through October 31, 2015 we have conducted 220 audits on taxpayers issuing 1099Misc. payments to ITIN holders and failing to properly withhold 4% individual income tax withholding. The amount of assessments associated with these audits is \$4.2 million. Based on our analysis and examination of taxpayer records, there is a large amount of non-compliance within this area.</p>
Alan Woodard & Anthony Edwards	5.	<p>A practitioner submitted the following: I just spoke to a NC auditor regarding a client whose corporate returns were subject to a federal IRS audit for 2011 and 2012. The '11 audit resulted in taxes due and the '12 resulted in a refund. NC has been provided this information by the IRS and sent a notice due for the 2011 state taxes. When I told her that her notice didn't include 2012 but we were filing an amended NC return for that year also, she told me that she knew about the 2012 adjustment but their policy is to not send a refund and let the taxpayer claim that overpayment themselves if they choose to do so. This seems to be an inconsistency that is not fair to taxpayers. The Department receives Revenue Agents Reports from the Internal Revenue Service for many tax schedules. Your question indicates Corporate Income tax. So, with respect to corporate income tax, the NCDOR matches the RAR information to determine if an amended corporate income tax return has been filed reflecting the Federal Determination. If an amended return has not been filed, the Department processes the RAR in accordance with G.S. 105-130.20 and G.S. 105-241.8 with respect to an assessment of additional tax. The Department processes</p>

		<p>the RAR reflecting an overpayment in accordance with G.S. 105-241.7 which requires the taxpayer to file a final return before a refund can be issued. The Department does, however, send a letter to the taxpayer indicating that we have received information from the IRS indicating the taxpayer may be entitled to a refund based on a Federal Determination and a return reflecting the federal changes must be filed in order to claim it. Generally, if our auditors are engaged in a field audit, the taxpayer will provide the auditor an amended return reflecting the Federal Determination. The auditor will accept the amended return on behalf of the Agency and incorporate the overpayment into the audit findings.</p>
Alan Woodard & Anthony Edwards	6.	<p>A practitioner submitted the following: NC sends assessment notice after learning of IRS notice (CP2000?), but ignores the fact that the IRS issue was resolved with nothing due. We have had a number of instances where we get an IRS notice and successfully resolve it, and then a few months later we get a NC notice piggy-backing on the federal issue that had been successfully resolved in the client's favor. This seems to represent an unfair policy or perhaps it is just a timing issue. What timeframes apply to IRS notifying NC of assessment notices and resolution of those notices? The NCDOR receives six CP2000 extracts from the IRS annually. However, the IRS sends the CP2000 information to the Department two years after the close of the tax year of the adjusted return. The IRS only includes in the CP2000 extract sent to the NCDOR changes that are considered agreed to by the taxpayer. If the taxpayer did not respond timely to the IRS regarding a proposed change, the change is considered agreed to. The examination division processes this information within two weeks of receiving the data from the IRS. Currently, the IRS does not have a process in place to provide the Department with any adjustments to accounts after the IRS has issued a notice of additional tax due. According to the IRS Governmental Liaison, if taxpayers respond to the initial inquiry from the IRS, and resolve the issue prior to a Notice of additional tax due, the taxpayer data will not be transmitted to the Department. If you have specific Notices, please provide them, and we will be happy to research and provide you with an update.</p>

C. Communications		
Charlie Helms	1.	<p>Several practitioners have complained about the lack of correspondence and notices being sent to the taxpayer's POA (after providing a properly executed NC Gen. 58). We understand there are deficiencies in your existing system that prevents this but this is causing severe hardships in a number of cases. What are the plans to rectify this situation? This issue is due to limitations with our current tax processing system. The eServices RFP was issued this Fall and we expect to award the contract by the end of the calendar year.</p>

D. Operations		
Alan Woodard & Jerry Coble	1.	<p>Practitioners continue to report that the NCDOR seems to "hold" refunds until some inquiry of the status is made and then the practitioner is told the refund has been approved and is scheduled for refund. This seems to happen too often to be isolated cases. Comments by the NCDOR? For clarification, the NCDOR does not hold</p>

		<p>refunds until an inquiry is made by a taxpayer. However, the NCDOR does have a robust refund fraud program designed to protect from identity theft refund fraud and erroneously issued refunds. The Department, on average, saves North Carolina taxpayers over \$21 million dollars in refund fraud each year. All individual income tax returns filed with the Department pass through certain levels of threshold, criteria, and scoring mechanisms to determine if potential fraud exists. Generally, our refund fraud mechanisms are operating concurrently with normal processing of the tax return within ITAS, and there is no delay in processing for roughly 96% of the tax returns filed with the Department. Some tax returns are identified as potential fraudulent tax returns. When a tax return is identified as potentially fraudulent, our staff conducts a higher level of research and review of the return and either approves the requested refund, adjusts the return to reflect the corrected refund amount, or sends a letter to the taxpayer requesting additional information.</p>
<p>Alan Woodard</p>	<p>2.</p>	<p>NC appears to "hold" amended returns until the federal amended return has been accepted. This seems inconsistent with the fact timely filed original returns are processed prior to any "acceptance" by IRS. So why are amended returns delayed? What can practitioners do to assist or speed up the process? It is not the Department's policy to "hold" amended returns or wait for IRS approval of the amended return before the NCDOR processes the amended return. The Examination Division reviews all amended returns filed with the Department, which averages approximately 95,000 amended returns each year. Procedurally, after an initial review of the amended return, if additional documentation is needed to support the amended return, the auditor will mail an Information Document Request (IDR) to the taxpayer asking for specific information. The IDR allows the taxpayer 30 days to provide the requested information. The auditor's contact information is furnished within the letter. If all requested information is provided to the taxpayer, the auditor will review and take appropriate action. If the taxpayer communicates to the auditor, and advises that additional time is needed to secure and provide the requested information, the auditor will mutually agree to extend the time period to provide the requested information. In some cases the IRS approves or denies the amended return prior to the taxpayer providing the requested information. The practitioner community can facilitate the process by ensuring all documentation needed to substantiate any adjustments to the original return is attached to the amended return and/or all information requested by the auditor is provided timely. Please be mindful, cases cannot remain open indefinitely without communication to the auditor. If the taxpayer fails to respond to correspondence from the auditor or fails to communicate progress and request additional time, the case will be closed based on the information available. In the same manner, if you have a specific case, where the taxpayer remained in communication with the auditor, provided all requested information, and the auditor failed to take action timely, please let me know so I can identify any gaps in our procedures.</p>
<p>Jerry Coble</p>	<p>3.</p>	<p>When will electronic filing of individual extensions be available? Electronic filing for individual extensions has been available for some time on the NCDOR website. The link is http://dornc.com/electronic/index.html#individuals.</p> <p>In July 2014 we added extensions, estimated, and tax due payments to the Fed/State Modernized e-File process. We currently have several e-file providers that provide these options in their tax preparation software. The link to the approved vendors that offer these options is located at:</p> <p>http://dornc.com/electronic/individual/approved_products_returnandpayments.pdf.</p>

Jerry Coble	4.	When will e-filing of fiduciary returns be available? Our go live date is March 15, 2016.
Jocelyn Andrews and Jerry Coble	5.	There seems to be some issues with the e-filing of corporate returns with the NCDOR and the mailing of the Annual Reports to the Secretary of State. Since e-filing was not available until after the original due date of calendar year returns, most of the returns that were e-filed were extended returns, meaning the annual report fee had typically been paid to the NCDOR with the corporate extensions. Several practitioners reported clients receiving notices from the Secretary of State's office of nonpayment of the annual report fee and requested proof of payment. This created significant inconvenience for taxpayers and practitioners. Has the NCDOR addressed this problem and are any procedural or filing changes being implemented to alleviate this problem for the filing of 2015 returns? At present, Annual Reports cannot be filed electronically with the NCDOR. We are working with the Secretary of State's office on the future state of this process. We do not anticipate that the NCDOR will be able to accept electronically filed Annual Reports until sometime after the 2016 filing season.
Jerry Coble	6.	Practitioners report that there is a known problem within the business e- services system with payroll tax deposits and payment drafts not being completed. What can practitioners do to assure payments are being credited timely? What plans are there to make changes to the system to eliminate these issues? This issue may involve payments which were not drafting due to new required validations with our processing vendor. These checks or validations which were causing payments to be declined were removed on November 4th and should no longer be an issue.
David Roseberry	7.	We learned last year that the TIMS project was terminated. What processes are in place or being considered to update the existing the NCDOR computer system? What are your priorities for improvements? The eServices RFP was issued this Fall and we expect to award the contract by the end of the calendar year. The first year of the project will focus on modernizing the platform to allow access from mobile devices and modern browsers.

E. Suggestions		
Lennie Collins	1.	Many states accept the federal extension if no tax is due to the state. Would the NCDOR consider adopting this process? No, NC extension forms are trained for automated processing. Federal forms would require manual processing.
David Roseberry and Jerry Coble	2.	The IRS e-services system provides a lot of benefit to practitioners who are assisting their taxpayer clients. The NCDOR had planned to make a similar service part of the TIMS system that has now been abandoned. What progress is planned to implement such a service outside the TIMS project? The eServices RFP was issued this Fall and we expect to award the contract by the end of the calendar year. The first year of the project will focus on modernizing the platform to allow access from mobile devices and modern browsers.

F. Additional Questions		
Jocelyn Andrews	1.	<p>The content of the NC POA (Form Gen. 58) is practically the same as the federal Form 2848. In order to use the federal Form 2848 for NC purposes, is the only adjustment practitioners need to make is to specifically list "NC individual tax" and the "NC Form D-400" (or other appropriate form) on Line 3 of the federal Form 2848? The Department prefers that Form GEN-58 be filed. However, federal Form 2848 or another alternative form may be filed in lieu of Form GEN-58, provided the form includes all pertinent information requested on Form GEN-58 and specifies that a taxpayer is authorizing the Department to discuss North Carolina State tax matters with the named representative(s).</p> <p>If a durable or military power of attorney is submitted, please include the following information:</p> <ul style="list-style-type: none"> ○ Name ○ Social Security Number(s) and/or Fed Employer ID Number ○ Representative's Name ○ Type of Tax ○ Year(s) or Period(s) ○ Date ○ Signature
Jocelyn Andrews and Jerry Coble	2.	<p>Please provide an updated telephone directory for the NC Department of Revenue. The NCDOR has a phone line dedicated to paid preparers to ensure timely response from the Department. Tax Practitioners can call 919-754-2500, between 8:00 a.m. and 5:00 p.m. EST, Monday through Friday, to speak with Department of Revenue tax professionals who can assist them with many of their technical and account specific questions about corporate income and franchise tax, individual income tax, sales and use tax, and withholding tax. By calling the (TPPS) Tax Practitioner Priority Service line, preparers will ensure they are receiving Level 3 assistance.</p>