

S.L. 2018-5 AND OTHER LEGISLATIVE BUDGETARY HIGHLIGHTS

Finance Highlights

Highlights of the Conference Committee and other legislative actions in Finance matters follow:

Special Provisions:

- **(Section 38.1, Pages 229-233) Updates the reference to the Internal Revenue Code (IRC)** from January 1, 2017, to February 9, 2018. Except as provided below, this means that to the extent North Carolina follows federal tax provisions in calculating State tax liability, changes made to the IRC by the Federal Tax Cuts and Jobs Act (TCJA) and the Bipartisan Budget Act of 2018 will apply to North Carolina.

This Section would decouple from two of the tax changes included in TCJA:

- The deferral of gain and the exclusion of gain for assets invested in an Opportunity Fund.
- The inclusion, and deduction, associated with foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI).

The Bipartisan Budget Act of 2018 temporarily reduces the threshold for deducting medical expenses from 10% to 7.5% of income for the 2017 and 2018 taxable years. This Section conforms to this change. This Section decouples from the extension of three provisions from which North Carolina has historically decoupled:

- (i) income exclusion for forgiveness of debt on primary residence;
- (ii) mortgage insurance deductible as mortgage interest; and
- (iii) deduction for tuition and expenses.

- **(Section 38.2, Pages 233-235 – as amended by S.L. 2018-97, Sec. 11.2)** Closes a franchise tax loophole and makes other technical, administrative, and clarifying changes.
- **(Section 38.3, Pages 235-238)** Clarifies when a taxpayer must notify the Secretary of Revenue as the result of either a federal determination or a voluntary filed amended federal return that affects the amount of State tax payable. Clarifies the meaning of a "federal determination."
- **(Section 38.4, Page 238)** Provides that a taxpayer who is granted an automatic extension to file a federal income tax return is granted an automatic extension to file a State income and franchise tax return, effective for taxable years beginning on or after January 1, 2019. Currently, a taxpayer must file a State tax extension form. NC does not receive copies of federally filed extension forms. An extension of time to file a return is not an extension of time to pay the amount of tax due.

- **(Section 38.5, Pages 238-252)** Makes technical and administrative changes to the Sales and Use tax statutes and provides clarification on frequently questioned transactions. Also makes two more substantive changes:
 - Provides a way for a retailer to recover sales tax paid on items the retailer subsequently resells.
 - Extends the grace period allowed to retailers impacted by recent sales tax base expansion for one more year, until January 1, 2019.

Also, Section 38.5(x) – (z), beginning on page 251, defines a property management contract and provides that a property management contract is not subject to sales tax. The effective date is January 1, 2020, and Revenue Laws is directed to review the provision. The service of providing property management is not currently subject to sales tax. However, RMI services that a property management company may perform in addition to its management services may be subject to sales tax.

- **(Section 38.6, Pages 252-257)** Makes technical, administrative, and clarifying changes to Excise Tax statutes.
- **(Section 38.7, Page 257)** Reduces the excise tax rate on modified risk tobacco products by 50% if the product is issued a risk modification order by the US Food and Drug Administration, and by 25% if the product is issued an exposure modification order by the US FDA. To date, the FDA has not issued any such orders. A modified risk tobacco product is a product that is sold or distributed for use to reduce harm or the risk of tobacco-related disease associated with commercially-marketed tobacco products.
- **(Section 38.8, Pages 257-259 – as amended by S.L. 2018-97, Sec. 11.1)** Adds "funding for elementary and secondary public education" to the list of purposes for which a city may impose property taxes. It also provides that cities may use property tax revenues and other unrestricted revenues to supplement funding for elementary and secondary public education that benefits the residents of the city:
 - For public schools located in the city limits, the funds may be used for capital, current operating expenses, and other specific uses as directed by the city, including operational and financing leases for real property or mobile classroom units and for payments on loans made to public schools for facilities, equipment, or operations.
 - For a public school located outside the city limits, the funds may be used on a per pupil basis for students attending that school who are residents of the city for current operating expenses or other specific uses directed by the city.

- **(Section 38.9, Page 259)** Establishes the date for performing an act required under the property tax laws, such as listing of property or payment of property taxes, as the next business day if the actual day is on a day that meets all three of the following: 1) The tax office is closed; 2) The taxpayer certifies in writing that the US Postal Service did not provide service to the taxpayer's address; and 3) A disaster declaration is declared pursuant to a gubernatorial, county, or municipal declaration.
- **(Section 38.10, Pages 259-265)** Makes other technical, clarifying, and administrative changes to the General Statutes concerning taxation. Makes the following more substantive tax changes:
 - Requires that lunch and dinner meals, served at the option of guests staying at a bed and breakfast home or inn, be charged separately on the guest bill.
 - Waives an antiquated restriction regarding sales and use tax revenue distributed to a municipality for water and sewer capital outlay purposes if the municipality does not own or operate a water or sewer system.
 - Modifies the existing penalty for failure to file an informational return and creates a \$200 penalty for failure to file an informational return in the proper format.
 - Provides a framework for the Department to offer and prescribe the format for electronic filings.