

North Carolina Amends Corporate Income Tax and Sales and Use Tax Laws

June 5, 2014

Overview

On May 29, 2014, North Carolina Governor McCrory signed House Bill 1050 (“H.B. 1050”).¹ The adopted legislation amends various provisions of the State’s corporate income tax and sales and use tax laws. In this Tax Alert we summarize the more prominent of these law changes.

Conformity with the Internal Revenue Code

H.B. 1050 updates the state’s conformity with the Internal Revenue Code (“IRC”) from January 2, 2013 to December 31, 2013, applicable to the 2013 taxable year.² However, any amendment to the IRC enacted after January 2, 2013, that increases North Carolina taxable income for the 2013 taxable year is effective for taxable years beginning on or after January 1, 2014.³

Replacing the Net Economic Loss

Effective for taxable years beginning on or after January 1, 2015, H.B. 1050 replaces the Net Economic Loss (“NEL”) with a “State Net Loss” (“SNL”), which is the amount by which allowable deductions for the year, other than prior year losses, exceed gross income under the IRC for the year as adjusted by N.C. Gen. Stat. § 105-130-5.⁴ The SNL must be allocated and apportioned in the year of the loss.⁵ Further, the Secretary of Revenue must apply the standards contained in the regulations under IRC §§ 381 and 382 when determining the amount of a loss that survives after a merger or an acquisition.⁶

In determining and verifying the amount of an NEL incurred or carried forward for taxable years beginning before January 1, 2015, the provisions of N.C. Gen. Stat. § 105-130.8 apply.⁷ Also, as stated in H.B. 1050, “Any unused portion of [an NEL] carried forward to taxable years beginning on or after January 1, 2015, is administered in accordance with this section.”⁸

Additional Guidance for Bonus Depreciation

Effective as of August 23, 2013, N.C. Gen. Stat. § 105-130.5B provides that, in the event of an actual or deemed transfer of an asset, the transferor and transferee can make an election to make the basis adjustment required under N.C. Gen. Stat. § 105-130.5B(e) and (f) on the transferee’s 2013 tax return. H.B. 1050 provides additional guidance and clarification regarding the requirements of this election as well as the tax basis adjustments.⁹

Sales and Use Tax

Exemptions for Farmers

Effective July 1, 2014, H.B. 1050 amends N.C. Gen. Stat. § 105-164.13E, which includes the farming exemptions and related requirements. The new law adds an additional qualifying caveat, such that the exemptions are available only to farmers who have annual gross income from farming operations of at least \$10,000 for the

¹ *An Act to Amend the Revenue Laws, as Recommended by the Revenue Laws Study Committee*, General Assembly of North Carolina, Session 2014, House Bill 1050. A copy of the enacted law is accessible at:

<http://www.ncleg.net/Sessions/2013/Bills/House/PDF/H1050v6.pdf>.

² H.B. 1050, § 14.16(a) amending N.C. Gen. Stat. § 105-228.90(b)(1b).

³ *Id.* at § 14.16(b).

⁴ *Id.* at § 1.1.(c), (d).

⁵ *Id.* at § 1.1.(c).

⁶ *Id.*

⁷ Although N.C. Gen. Stat. § 105-130.8 has been repealed (see H.B. 1050, § 1.1.(b)), the statute remains applicable for determining NELs for taxable years beginning before January 1, 2015.

⁸ H.B. 1050 § 1.1.(c), adding new N.C. Gen. Stat. § 105-228.8A(e).

⁹ *Id.* at § 2.1.(a).

preceding taxable year *or* an average of \$10,000 per year for the three preceding taxable years.¹⁰ H.B. 1050 also allows a person that *will* engage in farming operations to obtain a conditional exemption certificate that is good for three years as long as that person agrees to file North Carolina and federal income tax returns that reflect the income and expenses from farming operations. Finally, a qualifying farmer must apply for a new exemption number from the Department of Revenue before July 1, 2014, for purchases to be made on or after October 1, 2014.¹¹ The existing exemption number can be used for qualifying purchases between July 1st and September 30th. If a farmer will not meet the new income requirements outlined above, the farmer must notify its sellers that the old exemption certificates on file with such sellers are no longer valid.¹²

Prepaid Meal Plans

Effective July 1, 2014, sales and use tax will be imposed on the sale of prepaid meal plans offered by institutions of higher education.¹³ The tax is sourced to where the food will be consumed.¹⁴ Effective January 1, 2014, H.B. 998 had removed the sales and use tax exemption for *meals* sold in institutions of higher education. H.B. 1050 attempts to simplify the sales and use tax administration related to this issue by subjecting sales of prepaid meal plans to sales and use tax as well.

Admissions Charges to an Entertainment Activity

Effective on May 29, 2014 (the adoption date of H.B. 1050), the new law amends a previous law change (H.B. 998, adopted in August 2013 and effective on January 1, 2014) regarding the sales tax imposed on entertainment activity admissions charges. H.B. 1050 amends applicable law to state that the sales tax applies to the *gross receipts* of select admissions to an entertainment activity.¹⁵ By applying it to gross receipts, items such as convenience fees, surcharges, facilitation fees, etc. are now included in the tax base. H.B. 1050 also defines the term “facilitator” and discusses the sales and use tax responsibilities of the facilitator with respect to any arrangements it may have with the venue operator.¹⁶ H.B. 1050 provides some new exceptions and clarifies existing exceptions and exemptions to the tax on the gross receipts from admissions. Finally, the amended law provides that gross receipts from an admission charge sold on or after January 1, 2015 are subject to sales tax, and not the gross receipts privilege tax that had been imposed on entertainment venues,¹⁷ regardless of when the initial ticket to the event was sold.¹⁸ This last change is effective January 1, 2015 for events that occur on or after that date.

Service Contracts

Effective October 1, 2014, H.B. 1050 amends the definition of a service contract as contained in N.C. Gen. Stat. § 105-164.3(38b).¹⁹ The sales tax is to be charged and collected by the retailer of the service contract. The amended law provides guidance to help identify the applicable retailer.²⁰ Additionally, H.B. 1050 adds exemptions and exceptions related to service contracts and outlines the sales and use tax refund provisions and requirements related to cancellations of the service contract.²¹ Finally, H.B. 1050 modifies the sales and use tax exemption related to items used to fulfill a service contract if the purchaser of the contract is not charged for the item, such that this exemption does not apply to tools, equipment, supplies, etc. used in fulfilling the contract.²²

Contractors

Effective January 1, 2015, H.B. 1050 modifies the sales and use tax definitions to add definitions for real property contractors and retailer-contractors.²³ Additionally, the amended law provides a new statutory imposition section

¹⁰ *Id.* at § 3.1.(a).

¹¹ *Id.* at § 3.1.(d).

¹² *Id.* at § 3.1.(e).

¹³ *Id.* at § 4.1.(b).

¹⁴ *Id.* at § 4.1.(c).

¹⁵ *Id.* at § 5.1.(a).

¹⁶ *Id.* at § 5.1.(c).

¹⁷ This privilege tax was repealed effective January 1, 2014, with the new imposition of sales tax on the admission charge. However, if there was a taxable entertainment activity held after January 1, 2014, whereby an initial ticket to the event was sold prior to January 1, 2014, prior to H.B. 1050 *all* admissions to that event would have been exempt from the sales tax and instead subject to the gross receipts privilege tax.

¹⁸ H.B. 1050, at § 5.1.(f).

¹⁹ *Id.* at § 6.1.(a).

²⁰ *Id.* at § 6.1.(c).

²¹ *Id.* at § 6.1.(d).

²² *Id.* at § 6.1.(f).

²³ *Id.* at § 7.1.(a).

that outlines the taxability of tangible personal property purchased and used by real property contractors, retailer-contractors, and their subcontractors.²⁴

Additional Changes

In this Alert we do not provide a comprehensive review of all changes contained in H.B. 1050. Taxpayers should note that in addition to the changes summarized above, H.B. 1050 provides changes related to the following:

- Taxation of tobacco vapor products
- Property taxation of mobile telecommunications companies
- Motor fuel excise taxes and motor carriers
- Authority of cities, towns and counties to impose certain privilege license taxes²⁵

Contacts

If you have questions regarding H.B. 1050 or other North Carolina tax matters, please contact any of the following Deloitte Tax professionals.

John W. Galloway
Partner
Deloitte Tax LLP, Charlotte
jgalloway@deloitte.com
(704) 887-1619

Brian Hollingsworth
Senior Manager
Deloitte Tax LLP, Raleigh
bhollingsworth@deloitte.com
(919) 546-8159

Arthur E. Tilley
Senior Manager
Deloitte Tax LLP, Charlotte
atillye@deloitte.com
(704) 887-1551

Nicole Rooney
Manager
Deloitte Tax LLP, Charlotte
nrooney@deloitte.com
(704) 887-1510

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2014 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited

²⁴ *Id.* at § 7.1.(c).

²⁵ The new law also makes changes in addition to those listed in these four bullet items.