

PUBLICATION

Spotlight on North Carolina: Penalty Waivers Possible for Certain Corporate Income and Franchise Tax Issues; Amazon Law Enacted

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North Carolina's Department of Revenue (DOR) has launched an informal resolution initiative in hopes of generating additional revenue and resolving outstanding tax disputes involving certain controversial areas of state corporate income and franchise tax. Under the initiative, DOR auditors are contacting corporate taxpayers and offering to waive penalties if the taxpayer agrees to pay taxes and interest associated with three categories of tax issues. Though directed at corporate taxpayers under audit or appeal in North Carolina, corporate taxpayers who are not under audit can also participate in the resolution initiative.

Taxpayers interested in participating in the resolution initiative must act quickly, despite the absence of any information about the initiative on the DOR's website. According to published reports, interested taxpayers must sign nonbinding elections to participate in the initiative by September 15, 2009, and will only receive the penalty waivers under the initiative if they enter into binding resolution agreements with the DOR by November 15, 2009.

The resolution initiative targets the following controversial corporate income and franchise tax issues:

1. Economic Nexus for Credit Card Issuers. Relying on court decisions from other states and a 2004 North Carolina decision involving trademark licensing, the DOR is asserting that out-of-state issuers of credit cards to North Carolina residents have corporate income and franchise tax nexus with North Carolina. According to a report from BNA, the director of the DOR's Corporate, Excise and Insurance Tax Division stated the DOR will seek back taxes and interest from the 2004 tax year forward from issuers of private label cards, and from the 2006 tax year forward from companies soliciting credit cards by mail or the internet.
2. Income-Shifting and Combination Arrangements. The DOR believes the recent North Carolina Court of Appeals decision in *Wal-Mart Stores East, Inc. v. Hinton*, No. COA08-450, 676 S.E.2d 634, May 19, 2009, which is still pending on appeal to the North Carolina Supreme Court, authorizes it to force combined returns on related corporations suspected of using tax planning to "shift" income to avoid North Carolina taxes. The North Carolina voluntary disclosure program is not available to corporate taxpayers who have engaged in income shifting tax strategies, so this initiative provides the opportunity to resolve audit issues arising from certain tax planning without penalties while the Wal-Mart case is on appeal. The period for which taxes and interest are being sought by the DOR can vary, but is generally three years.
3. Franchise Tax Issues. Franchise tax issues covered by the resolution initiative involve: (a) capital stock base calculations involving billings in excess of cost from taxpayers using the percentage of completion method of accounting; (b) capital base adjustments for amortization of intangible property; and (c) deductions of pension reserves from the capital stock base.

Though quick action is required because elections to participate in the resolution initiative are due by September 15, 2009, corporate taxpayers should keep in mind that the corporate income tax issues included in the resolution initiative involve rapidly developing and fiercely debated and contested areas of state tax law. Please consult your tax advisors before electing to participate.

New "Amazon Law" Nexus Standard for Online Retailers. In related news, North Carolina just enacted a so-called "Amazon Law," joining Rhode Island and New York on the list of states asserting sales tax nexus with out-of-state retailers through their relationships with in-state vendors. According to the DOR's summary of new tax laws, the newly enacted North Carolina statute provides that "[o]nline retailers who have more than \$10,000 worth of sales through online referrals from websites owned by North Carolina residents - such sales are also known as "click-thru's [sic]," - may need to charge sales tax on all sales to North Carolina residents."¹

Should you wish to discuss these North Carolina tax developments in more detail, please contact any of the following attorneys in the Firm's Tax Department.

¹ <http://www.dornc.com/aboutus/education/lawchanges2009.html>