



PROJECT COMPLIANCE

FTA 72nd Annual Meeting

Providence, Rhode Island

June 6-9, 2004

- *John W. Sadoff*
 - Director Examination Division
 - North Carolina Department of Revenue
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Project Compliance

Tax Compliance – NCDOR

Divisions:

Collections

Examination

Taxpayer Assistance

Alan P. Felton

- Assistant Secretary – Tax Compliance
- North Carolina Department of Revenue
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Secretary of Revenue

E. Norris Tolson

North Carolina Department of Revenue
501 N. Wilmington Street
PO Box 25000
Raleigh, NC 27640
(919) 733-7211



Tax Compliance Issues

- *Individual Income Tax*
- *Sales & Use Tax*
- *Corporate Income & Franchise Taxes*



GENERAL FUND



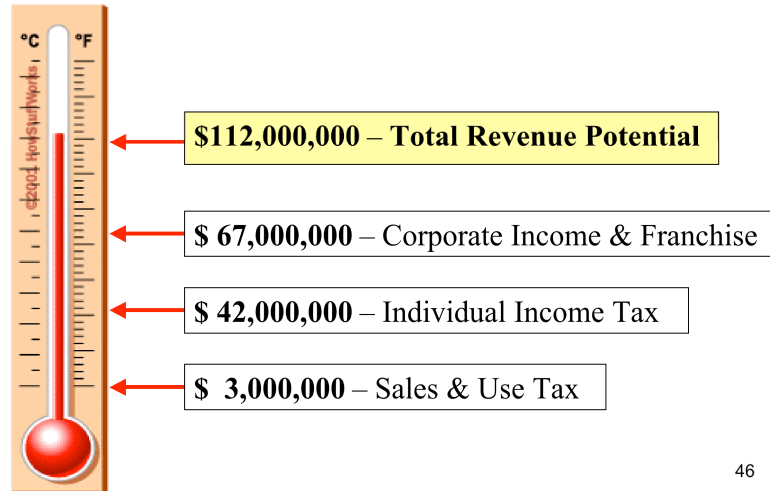
PROJECT COMPLIANCE

"It is a fairness issue; everyone paying their fair share."

**E. Norris Tolson
Secretary of Revenue**



Examination Division Revenue Potential



Project Compliance Revenue Estimates

Additional collections from audits:

FY-1 (July 2003-June 2004)

\$40 million – 1st year

FY-2 (July 2004-June 2005)

\$75 million – 2nd year

Project Compliance

Additional Staffing Requirements

FY-1

39 Total Positions

30 Examination Positions

FY-2

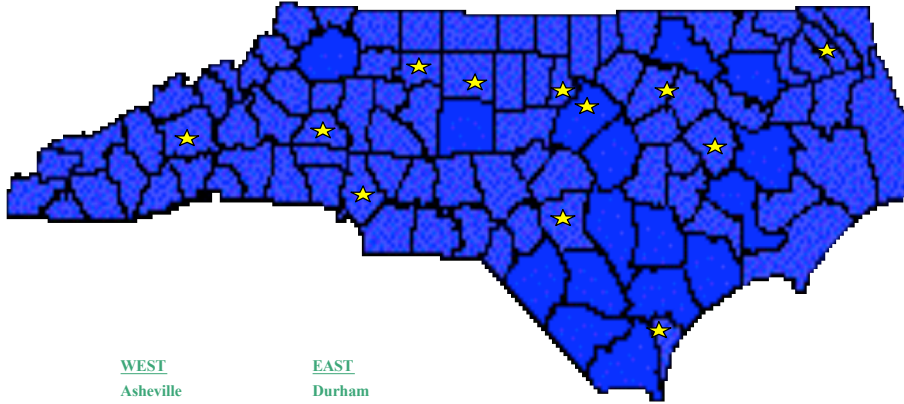
46 Total Positions (budgeted)

38 Examination positions

Examination Division



Examination Division 12- Field Office Locations



WEST

Asheville
Charlotte
Greensboro
Hickory
Winston-Salem

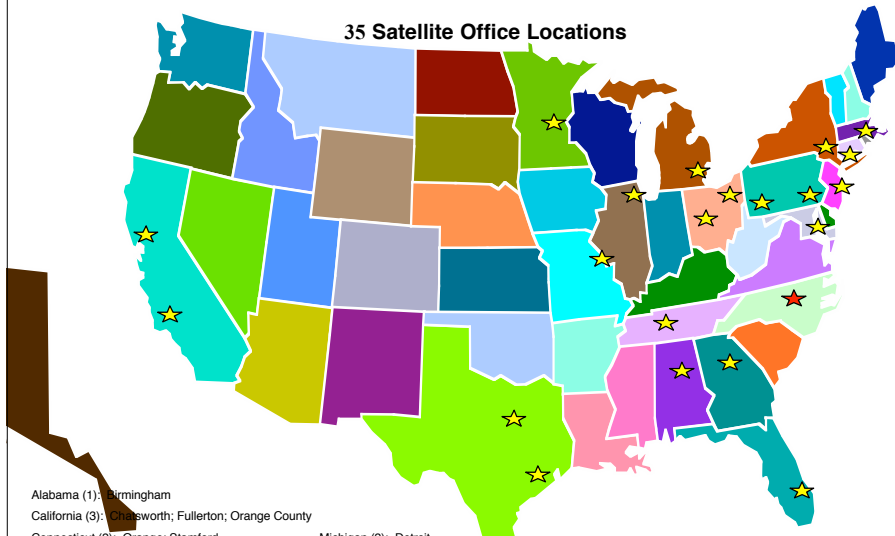
EAST

Durham
Elizabeth City
Fayetteville
Greenville
Raleigh
Rocky Mount
Wilmington

Interstate Examination Section

November 27, 2001

35 Satellite Office Locations



Alabama (1): Birmingham

California (3): Chagrowth; Fullerton; Orange County

Connecticut (2): Orange; Stamford

Georgia (4): Atlanta Metro area

City; Huntingdon Valley

Florida (2): Ft. Lauderdale; Tampa

Illinois (3): Chiagoland area

Maryland (1): Baltimore area

Massachusetts (1): Boston area

Michigan (2): Detroit

Minnesota (1): St. Paul/Minneapolis

Missouri (1): St. Louis

New Jersey (1): Plainfield

New York (3): Jamaica; New York; Suffern

Ohio (3): Chagrin Falls; Cleveland; Liberty Township

Oregon (1) Portland

Pennsylvania (2): Homer

Tennessee (1): Nashville

Texas (3): Dallas (1); Houston (2);

Central Examination Section

Raleigh based Tax Auditors and Tax Technicians

Individual Income Tax

RAR's; tax protesters; non-filers; return errors

Corporate/Franchise

RAR's; Amended Returns; Return errors

Sales & Use Tax

Claims for refund; return errors

Gift, Inheritance, Fiduciary, Partnerships

Discovery & Special Projects

Fraudulent return preparers; fictitious returns;
nexus programs; voluntary disclosures

Project Compliance

FY-1

30 new Examination Positions

10 -Tax Technicians

11-Tax Auditors

9-Field Auditors

Examination Initiatives FY 03-04



Individual Income Tax Issues

- *Non Filers*
- *Abusive Tax Avoidance Transact*
- *Fraudulent Return Preparers*
- *NC-4 Issues*
- *NC-4 Immigrant Workers*
- *Individual Income Tax Return Errors*
- *Noncompliance - Schedules A & C*
- *Noncompliance - 1099 NRS*



Non-Filers

1999 & 2000 tax years in progress

Results: 31,000 non-filers assessed

\$6.3 million collected

Abusive Tax Avoidance Transactions

Partnering with IRS

\$22.1 million assessed

\$12.27 million collected

Fraudulent Return Preparers Fraudulently Prepared Returns

- **Two Key Issues:**
 - **Identify and pursue *Paid Preparers* filing incorrect/false returns**
 - **Examination of tax returns of clients of *Paid Preparers***

Fraudulent Return Preparers Fraudulently Prepared Returns

Paid Preparers referred to CID

- ***Individual income tax cases (7-03 to 5-04)***
- ***2,500 cases examined***
- ***\$5.25 million taxes recovered***

NC-4

The image shows a thumbnail of the NC-4 Employee's Withholding Allowance Certificate form. The form is titled "NC-4 Employee's Withholding Allowance Certificate" and is issued by the North Carolina Department of Revenue. It contains various sections for the employee to fill out, including "EMPLOYEE INFORMATION", "EMPLOYER INFORMATION", "EMPLOYEE'S WITHHOLDING ALLOWANCE INFORMATION", and "EMPLOYEE'S SIGNATURE". The form is designed to be used by employers to determine the amount of state income tax to withhold from an employee's wages.

- *Excessive* allowances claimed
- Claiming “exempt”
- Immigrant employees

NC-4/W-4

- 1,050 NC-4's corrected
- 1,100 individuals audited
- \$2.57 million recovered

Immigrant employees

- >false social security numbers**
- >false names**
- >minimum or no withholding**
- >7-8 allowances claimed**
- >no returns filed**

Schedules A & C

- Overstated Itemized Deductions**
- Excessive Schedule C expenses**
- 97% of cases selected were adjusted**

1099-NRS

- *Sales of real property located in N.C. by Non-residents*
- Non-filers determined by a program which matches the information on the 1099NRS against NCDOR individual income tax database
- **Results: \$2.2 million**

NC-1099NRS
4.02

Report of Sale of Real Property by Nonresidents
North Carolina Department of Revenue

The buyer must file this form within 15 days of the closing date of the sale.

Part 1. Seller's Information (See instructions on reverse.)
Fill in applicable circle: Individual Partnership Estate Trust Other (Specify) _____

Individual's First Name (USE CAPITAL LETTERS) MI Individual's Last Name (USE CAPITAL LETTERS) Individual's Social Security Number
Spouse's First Name (If properly owned jointly) MI Spouse's Last Name (If properly owned jointly) Spouse's Social Security Number
Entity's Legal Name (USE CAPITAL LETTERS) Federal Employer ID Number
Address County
City State Zip Code Country (If not U.S.)
Contact's First Name MI Contact's Last Name Contact's Phone Number

Part 2. Buyer's Information
Fill in applicable circle: Individual Partnership Estate Trust Other (Specify) _____

Individual's First Name (USE CAPITAL LETTERS) MI Individual's Last Name (USE CAPITAL LETTERS) Individual's Social Security Number
Spouse's First Name MI Spouse's Last Name Spouse's Social Security Number
Entity's Legal Name (USE CAPITAL LETTERS) Federal Employer ID Number
Address County
City State Zip Code Country (If not U.S.)

Part 3. Sale Information

Is the transaction for the sale of a personal residence? (If a duplex circle) Yes No

Gross sale price \$ _____,00
County in which property is located _____
Date of closing (MM/DD-YY) _____

Enter the book number and page number in which the deed is recorded. Book number _____ Page number _____

Part 4. Authorized Signature
I certify that, to the best of my knowledge, this report is accurate and complete.

Preparer's Name (Please Print) _____ Telephone Number (include area code) _____
Preparer's Signature _____ Date _____

1099NRS2012

Mail To: North Carolina Department of Revenue, Field Operations Division, P.O. Box 871, Raleigh, NC 27602-0871

Other... real estate conveyances

- *100 counties in North Carolina**
- *Contacted to obtain electronic data
on real property sales**
- *Focus on mountain and coastal
counties**

Tax Return Errors

- Credits**
 - Part-year resident**
 - Non-resident pro-rations**
 - Long term health care insurance**
- Additions to Federal taxable income**
- FTI different from 1040 to D-400**

Sales & Use Tax Initiatives:

- Agricultural Certificates

- Consumer Use Tax

SEATA

U S Customs

Wildlife Resource Commission

- U S Customs

Non-filers

Understated sales/purchases

Form E-699
01-02

North Carolina Department of Revenue
Post Office Box 26000
Raleigh, North Carolina 27640

AGRICULTURAL CERTIFICATE

Vendor: _____
Vendor's Address: _____

PART I. FARM MACHINERY
To be executed by farmers and producers in connection with purchases, leases, or rentals of tangible personal property subject to the 1% rate of State sales or use tax. The maximum tax is \$80.00 per article, of machinery.

Description of Property Purchased, Leased, or Rented	Sales Invoice Number and Invoice Date

PART II. AGRICULTURAL EXEMPTIONS
To be executed by farmers, producers, and commercial animal farmers for the purchases of the following items that are exempt from sales or use tax:

SEEDS purchased by farmers for agricultural purposes. G.S. 105-164.13(1)

FERTILIZER, LIME, OR LAND PLASTER purchased by farmers for agricultural purposes. G.S. 105-164.13(2)

PACKAGING MATERIALS purchased by farmers and producers. G.S. 105-164.13(2)a

FEED purchased for animals held or produced for commercial purposes. G.S. 105-164.13(2)a

TANGIBLE PERSONAL PROPERTY purchased by commercial animal farmers or contractors or subcontractors for a commercial animal farmer. G.S. 105-164.13(4). See Instruction 2 on reverse.

Description of Property Purchased	Type of Agricultural or Commercial Activity

Type of Animals Held or Produced (For Commercial/Animal Farmer Exemption)	Sales Invoice Number and Invoice Date

CERTIFICATION
All farmers, producers, and commercial animal farmers executing this certificate and attesting to the information indicated in Parts I or II must complete the information below.

The undersigned farmer, producer, or commercial animal farmer certifies that the tangible personal property identified above and acquired pursuant to this certificate is subject to the 1% rate of State tax, maximum \$80.00 per article, or is exempt because of the type of property or the purposes for which it is used. If it is determined that the tangible personal property is subsequently used in a manner that renders it subject to sales or use tax or subject to additional sales or use tax, the undersigned agrees to assume liability for the additional tax, plus interest and applicable penalties, and will remit payment directly to the North Carolina Department of Revenue.

Under the provisions of G.S. 105-236(7), any person who willfully attempts, or who aids or abets any person to attempt, in any manner to evade or defeat any tax imposed by law, or the payment of the tax, is guilty of a Class I felony. Punishment for this offense may include a fine up to \$25,000. For each misuse of an agricultural certificate by a purchaser, the Secretary must assess against the purchaser an additional tax, as a penalty, of \$250.

Purchaser: _____
Purchaser's Address: _____

1 of 2 | 8.5 x 11 in

South Eastern Association of Tax Administrators



SEATA

- Exchange of tax information among the 12 member SEATA states
 - Consumer use tax
 - Nexus questionnaires
 - Assessments > \$100,000



U.S. Customs

U.S. Customs' *data* provides information on all *tangible property imported into North Carolina* from outside the United States.

Wildlife

Vessels: Registration and Titling Information

LICENSES/PERMITS/REGISTRATION/TITLING



- Boats purchased from vendors located outside North Carolina
- Purchasers pay no sales or use tax
- Boats are registered with Wildlife Resources Commission

Use Tax Reported on Income Tax Returns

2000 \$4.9 million

2001 \$4.68 million

2002 \$4.62 million

(4 million + returns filed; 4% remit use tax)

Corporate Income and Franchise

- William S. Lee Tax Credits
- Corporate/Franchise Non-filers
- Holding Companies:
 - Trademarks**
 - Investments**
 - Mortgages**

William S. Lee Tax Credits

(Tax Incentives for New & Expanding Businesses)

Key Issues:

- Eligibility for credits
- Financial data to support credits claimed

Examination Results

(July 2003-May 2004)

104 corporate cases closed

\$17.47 million disallowed

\$37.95 million future installments reduced

Inventory:

262 open cases

\$70.5 million credits

\$383 million future installments

Corporate Non-filers

Data Sources:

- *Secretary of State*
- *Employment Security Commission*
- *IRS BMF extract tape*

Intangible Holding Companies

- **Tax avoidance strategies to move North Carolina income from taxation by our State**
 - **Trademarks; Patents; Investments**
 - *interest income & expenses*
 - *royalty income & expenses*
 - *patent income & expenses*
- **Large Corporate Case Group**

Examinations

Separate entity state

- ✓ Federal consolidated return

IDR

- ✓ Agreements; Board of Directors; Job Descriptions; Flow of Funds

Failure to produce records

- ✓ 2 requests; next step
- ✓ Summons Procedures

Nexus; Combinations

North Carolina references:

A. Corporations Subject to the Tax, Tax Rate and Allocation Requirements (G.S. 105-130.3 and 105-130.4) (Section .0100)

1. “Doing Business” Defined

For income tax purposes, the term “doing business” means the operation of any business enterprise or activity in North Carolina for economic gain, including, but not limited to, the following:

- a. The owning, renting, or operating of business or income producing property in North Carolina including, but not limited to, the following:
 - i. Realty
 - ii. Tangible personal property
 - iii. **Trademarks, tradenames, franchise rights, computer programs, copyrights, patented processes, licenses**

North Carolina General Statute **105-130.6** “...If the Secretary finds as a fact that a report by a corporation does not disclose the true earnings of the corporation on its business carried on in this State, the Secretary **may require that corporation to file a consolidated return** of the entire operation of the parent corporation and of its subsidiaries and affiliates, including its own operations and income. The **Secretary shall determine the true amount of net income earned by such corporation in this State.** ...a corporation is considered an affiliate of another corporation when both are directly or indirectly controlled by the same parent corporation or by the same or associated financial interest by stock ownership, interlock directors, or by another means whatsoever, whether the control is direct or through one or more subsidiary, affiliated, or controlled corporations. The secretary may require a consolidated return under this section regardless of whether the parent or controlling corporation or interests or its subsidiaries or affiliates, other than the taxpayer are or are not doing business in this State.”

NCGS 105-130.16(b) states: “When the Secretary has reason to believe that any corporation so conducts its trade or business in such manner as to **either directly or indirectly distort its true net income and the net income properly attributable to the State**, whether by the arbitrary shifting of income, through price fixing, charges for service, or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantially common control, the Secretary may require any facts the Secretary considers necessary for the proper computation of the entire net income and the net income properly attributable to the State, and in determining these computations, the Secretary must have regard to the fair profit that would normally arise from the conduct of the trade or business.”

Royalty Reporting Option: Effective 2001

§ 105-130.7A. Royalty income reporting option. (a) Purpose. - Royalty payments received for the use of trademarks in this State are income derived from doing business in this State. This section provides taxpayers with an option concerning the method by which these royalties can be reported for taxation when the recipient and the payer are related members. As provided in this section, **these royalty payments can be either (i) deducted by the payer and included in the income of the recipient, or (ii) added back to the income of the payer and excluded from the income of the recipient.** (b) Definitions. - The following definitions apply in this section: (1) Component member. - Defined in section 1563(b) of the Code. (2) North Carolina royalty. - An amount charged that is for, related to, or in connection with the use in this State of a trademark. The term includes royalty and technical fees, licensing fees, and other similar charges. (3) Own. - To own directly, indirectly, beneficially, or constructively. The attribution rules of section 318 of the...



Project Compliance Goals (collections on field/office audits)

FY 03-04 **\$132 million**

Results 7-03 to 5-04

\$144 million

\$12 million over goal

Thank You!

