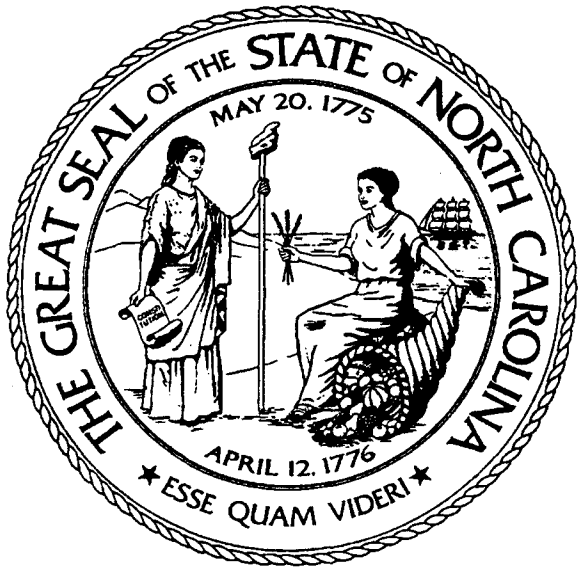
LEGISLATIVE

RESEARCH COMMISSION

REVENUE LAWS



REPORT TO THE
1997 GENERAL ASSEMBLY
OF NORTH CAROLINA

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STATE OF NORTH CAROLINA
LEGISLATIVE RESEARCH COMMISSION
STATE LEGISLATIVE BUILDING
RALEIGH 27601-1096

January 15, 1997

TO THE MEMBERS OF THE 1997 GENERAL ASSEMBLY:

The Legislative Research Commission herewith submits to you for your consideration its report on Revenue Laws. The report was prepared by the Legislative Research Commission's Committee on Revenue Laws pursuant to G.S.120-30.17(1).

Respectfully submitted

Harold J. Brubaker,
Speaker of the House of Representatives

Marc Basnight,
President Pro Tempore of the Senate

Cochairs

Legislative Research Commission

LEGISLATIVE RESEARCH COMMISSION
MEMBERSHIP
1995 - 1996

President Pro Tempore

Sen. Marc Basnight, Cochair
2007 State Legislative Building
Raleigh, NC 27601-1096
(919)733-6854

President Pro Tempore Appointments

Sen. Frank W. Ballance, Jr.
PO Box 616
Warrenton, NC 27589
(919)257-3955

Sen. R.L. "Bob" Martin
PO Box 387
Bethel, NC 27812
(704)825-4361

Sen. Henry McKoy
5300 Applegate Court
Raleigh, NC 27609
(919)787-2927

Sen. J.K. Sherron, Jr.
4021 Barrett Drive
Raleigh, NC 27609
(919)781-8721

Sen. Ed N. Warren
227 Country Club Drive
Greenville, NC 27834
(919)756-2671

Speaker

Rep. Harold J. Brubaker, Cochair
138 Scarboro Street
Asheboro, NC 27203
(910)629-5128

Speaker's Appointments

Rep. Jerry C. Dockham
PO Box 265
Denton, NC 27239
(704)869-3804

Rep. Larry Linney
PO Box 7628
Asheville, NC 28802
(704)254-7949

Rep. Edd Nye
403 Woodland Drive
Elizabethtown, NC 28337
(910)862-2420

Rep. Gregory J. Thompson
PO Box 574
Spruce Pine, NC 28777
(704)765-1992

Rep. Constance K. Wilson
726 Lansdowne Road
Charlotte, NC 28270
(704)364-2311

PREFACE

The Legislative Research Commission, established by Article 6B of Chapter 120 of the General Statutes, is a general purpose study group in the Legislative Branch of State Government. The Commission is cochaired by the Speaker of the House of Representatives and the President Pro Tempore of the Senate and has five additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly, "such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner." (G.S. 120-30.17(1)).

Prompted by legislation enacted during the 1995 and 1996 Sessions, the Legislative Research Commission has undertaken studies of numerous subjects. These studies were grouped into broad categories and each member of the Commission was given responsibility for one category of study. The Cochairs of the Legislative Research Commission, under the authority of G.S. 120-30.10(b) and (c), appointed committees consisting of members of the General Assembly and the public to conduct the studies. Cochairs, one from each house of the General Assembly, were designated for each committee.

The study of the revenue laws was authorized by Section 2.1(19) of Part II of Chapter 542 of the 1995 Session Laws. That Part states that the Commission may consider House Joint Resolution 246 in determining the nature, scope, and aspects of the study. House Joint Resolution 246, introduced by Representative John Gamble in the 1995 Session, gives the Legislative Research Commission's study of the revenue laws a very broad scope, stating that the "Commission may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable." The relevant portions of Chapter 542 of the 1995 Session Laws and House Joint Resolution 246 are included in Appendix A.

The Legislative Research Commission authorized the study of the revenue laws pursuant to its authority under G.S. 120-30.17(1) and grouped the study in its Budget and Revenue area under the

direction of Senator R. L. Martin. The Committee is chaired by Senator John H. Kerr, III and Representative Charles B. Neely, Jr. The full membership of the Committee and the staff assigned to the Committee are listed in Appendix B of this report. A committee notebook containing the committee minutes and all information presented to the committee is filed in the Legislative Library.

COMMITTEE PROCEEDINGS

The Legislative Research Commission's Revenue Laws Study Committee met six times before the 1996 Regular Session of the 1995 General Assembly and recommended fourteen bills in its interim report to the General Assembly. Ten of these bills were enacted in whole or in part during either the 1996 Regular Session or the 1996 Second Extra Session. Appendix C contains a summary of all tax legislation enacted in 1996 and Appendix D lists the Committee's recommendations and the action taken on them in 1996.

The Revenue Laws Study Committee held three meetings after the 1996 Sessions. The Committee was inundated with requests from legislators, taxpayers, the Department of Revenue, and interest groups to study numerous issues of tax policy and tax administration. The Committee considered many issues but was unable to take up all of the issues suggested to it.

The Committee continued to consider all proposed tax changes in light of general policies of tax policy and as part of an examination of the existing tax structure as a whole. The tax policies identified by the Committee were fairness, uniformity, application of low rates to a broad base, stability and responsiveness as a source of revenue, administrative efficiency, simplicity, and ease of compliance. In addition, the committee identified the tax policy of neutrality: the tax structure should not interfere unnecessarily with taxpayers' economic decisions.

Based on its consideration of these policies, the Committee investigated and adopted several proposals to give tax relief. These recommendations are reflected in Legislative Proposals 3, 4, 8, and 13. Legislative Proposal 4 would provide for automatic, annual tax reductions by preventing the gradual increase in personal income taxes that otherwise results as inflation increases the dollar amounts, but not the real value, of individuals' incomes. Legislative Proposal 13 would further tax simplicity and administrative efficiency by eliminating the inheritance tax, which is unnecessarily complex. Legislative Proposal 8 would simplify tax filing for consumers by allowing them to pay use taxes annually rather than monthly. Legislative Proposal 3 would provide relief to taxpayers who would otherwise be taxed unfairly when they earn money in one tax year but are required to refund it in a later year.

The Committee recognized a strong policy of administering taxes so that taxpayers cannot easily avoid paying the taxes they owe. When some taxpayers do not pay their taxes, the difference must be made up by raising taxes on those who comply with the law. Legislative Proposal 1 would require withholding from contract payments to or on behalf of nonresident individuals who perform personal services in this State. These nonresidents owe North Carolina income taxes on the income from performing services here but often do not pay. Legislative Proposal 6 would appropriate funds for additional interstate auditors, who will increase revenues by assessing taxes that are due but not paid.

The Committee recognized that the policy of tax fairness dictates that like taxpayers should be treated alike. It identified a provision of the current law that violates this principle: the sales and gross receipts taxes on piped natural gas apply to sales by utilities but not to sales by sellers who are not utilities. As more and more sellers who are not utilities enter the market, the State and local tax bases are eroded and the principles of fairness and neutrality are violated. Legislative Proposal 11 eliminates these problems by replacing the sales and gross receipts taxes on piped natural gas with a per therm tax that eliminates the distinction between sales by utilities and sales by others.

As in the past, the Committee proved to be an excellent forum for taxpayers and tax administrators to propose changes in the revenue laws. A number of taxpayers wrote to or appeared before the Committee to discuss tax problems they felt need to be resolved. As a result of input from taxpayers and tax administrators, the Committee recommends the following proposals: Legislative Proposal 5, which allows local governments to recover debts under the existing income tax refund setoff program for State debts and provides that the costs of the program will be borne by the debtors rather than the government agencies to whom debts are owed; Legislative Proposal 9, which revises the distinction between custom computer software, which is not subject to sales tax, and mass-produced computer software, which is subject to sales tax; Legislative Proposal 10, which allows local governments and nonprofit entities an additional period of time to apply for refunds of sales and use taxes they pay; and Legislative Proposal 14, which requires local governments to account annually for their use of funds collected to support improvements to 911 emergency systems. Legislative Proposal 2 contains the Committee's annual recommendation that references in State tax statutes to the Internal

Revenue Code be updated to include federal amendments made during the past year. Because of extensive changes to the Code enacted by Congress in 1996, this proposal will have a more significant impact on taxpayers and on the General Fund than in recent years. Appendix E contains a chart detailing the federal tax law changes that will affect State taxable income if this proposal is adopted.

The Committee studied numerous proposals for technical and administrative changes to the revenue laws raised by the Department of Revenue and by legislative staff. Legislative Proposal 7 allows the sale of personal property for delinquent taxes to occur in any county, rather than in Wake County as under current law; this change will reduce the administrative costs of levy and sale on personal property. Legislative Proposal 12 adjusts the formula for distributing part of the franchise gross receipts tax to municipalities, to eliminate unintended reductions in the amounts distributed to certain municipalities. Legislative Proposal 15 changes the licensing requirements for motor fuel exporters and makes clarifying changes to the new "tax at the rack" collection method. Legislative Proposal 16 contains the Committee's suggestions for technical, clarifying, and conforming changes to the laws.

Finally, Legislative Proposal 17 is the Revenue Law Study Committee's recommendation that the committee become a permanent, statutory commission, rather than a committee of the Legislative Research Commission whose authority must be renewed every two years. The Committee has been serving a vital role for more than twenty years; the General Assembly will benefit from an annual review of the revenue laws by a statutory legislative commission.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee recommends the following seventeen bills to the 1997 General Assembly. Each proposal is followed by an explanation and, if it has a fiscal impact, a fiscal note indicating any anticipated revenue gain or loss resulting from the proposal.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 1
97-LCX-003(1.1)
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Withholding for Nonresidents. (Public)

Sponsors: Representatives Neely, Blue, Cansler, Capps, Church, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REQUIRE WITHHOLDING FROM CERTAIN PAYMENTS TO NONRESIDENTS IN ORDER TO PREVENT NONRESIDENTS FROM AVOIDING NORTH CAROLINA INCOME TAXES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-163.1(15) reads as rewritten:

"(15) Wages. -- The term has the same meaning as in section 3401 of the Code except it does not include ~~remuneration paid by a farmer for services performed on the farmer's farm in producing or harvesting agricultural products or in transporting the agricultural products to market.~~ either of the following:

a. Remuneration paid by a farmer for services performed on the farmer's farm in producing or harvesting agricultural products or in transporting the agricultural products to market.

b. The first thirty-five thousand dollars ($35,000) of severance wages paid to an employee during the taxable year as the result

of the permanent closure of a manufacturing or processing plant."

Section 2. Article 4A of Chapter 105 of the General Statutes, as amended by Section 1 of this act, reads as rewritten:

"Article 4A

"~~Withholding of Income Taxes from Wages and Payment of Income Tax by~~ Withholding; Estimated Income Tax for Individuals.

"**§ 105-163.1. Definitions.**

The following definitions apply in this Article:

(1) Compensation. -- Consideration a payer pays a nonresident individual or nonresident entity for personal services performed in this State.

(2) Contractor. -- Either of the following:

a. A nonresident individual who performs personal services in this State for compensation other than wages.

b. A nonresident entity that provides for the performance of personal services in this State for compensation.

(3) Dependent. -- An individual with respect to whom an income tax exemption is allowed under the Code.

(4) Employee. -- An individual, whether a resident or a nonresident of this State, who performs services in this State for wages or an individual who is a resident of this State and performs services outside this State for wages. The term includes an ordained or licensed member of the clergy who elects to be considered an employee under G.S. 105-163.1A, an officer of a corporation, and an elected public official.

(5) Employer. -- A person for whom an individual performs services for wages. In applying the requirements to withhold income taxes from wages and pay the withheld taxes, the term includes a person who:

a. Controls the payment of wages to an individual for services performed for another.

b. Pays wages on behalf of a person who is not engaged in trade or business in this State.

c. Pays wages on behalf of a unit of government that is not located in this State.

d. Pays wages for any other reason.

(6) Individual. -- Defined in G.S. 105-134.1.

(7) Miscellaneous payroll period. -- A payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual, or annual payroll period.

(8) Nonresident entity. -- Any of the following:

a. A foreign limited liability company, as defined in G.S. 57C-1-03, that has not obtained a certificate of authority from the Secretary of State pursuant to Article 7 of Chapter 57C of the General Statutes.

b. A foreign limited partnership as defined in G.S. 59-102 or a general partnership formed under the laws of any jurisdiction other than this State, unless the partnership maintains a permanent place of business in this State

c. A foreign corporation, as defined in G.S. 55-1-40, that has not obtained a certificate of authority from the Secretary of State pursuant to Article 15 of Chapter 55 of the General Statutes.

(9) Pass-through entity. -- Defined in G.S. 105-163.010.

(10) Payer. -- A person who contracts to pay a nonresident individual or a nonresident entity compensation for personal services performed in this State.

(11) Payroll period. -- A period for which an employer ordinarily pays wages to an employee of the employer.

(12) Taxable year. -- Defined in section 441(b) of the Code.

(13) Wages. -- The term has the same meaning as in section 3401 of the Code except it does not include any of the following:

a. Remuneration paid by a farmer for services performed on the farmer's farm in producing or harvesting agricultural products or in transporting the agricultural products to market.

b. The first thirty-five thousand dollars ($35,000) of severance wages paid to an employee during the taxable year as the result of the permanent closure of a manufacturing or processing plant.

c. The amount an employer pays an employee as reimbursement for ordinary and necessary expenses incurred by the employee on behalf of the employer and in the furtherance of the business of the employer

(14) Withholding agent. -- An employer or a payer.

~~(1) Code. -- Defined in G.S. 105-228.90.~~

~~(2) Repealed by Session Laws 1989 (Regular Session, 1990), c. 945, s. 5.~~

~~(3) Dependent. -- An individual with respect to whom an income tax exemption is allowed under the Code.~~

~~(4) Employee. -- An individual, whether a resident or a nonresident of this State, who performs services in this State for wages or an individual who is a resident of this State and performs services outside this State for wages. The term includes an ordained or licensed clergyman who elects to be considered an employee under G.S. 105-163.1A, an officer of a corporation, and an elected public official.~~

~~(5) Employer. -- A person for whom an individual performs services for wages. In applying the requirements to withhold income taxes from wages and pay the withheld taxes, the term includes a person who:~~

~~a. Controls the payment of wages to an individual for services performed for another.~~

~~b. Pays wages on behalf of a person who is not engaged in trade or business in this State.~~

~~c. Pays wages on behalf of a unit of government that is not located in this State.~~

~~d. Pays wages for any other reason.~~

~~(6), (7) Repealed by Session Laws 1989 (Regular Session, 1990), c. 945, s. 5.~~

~~(8) Fiduciary. -- A guardian, a trustee, an executor, an administrator, a receiver, a conservator, or other person acting in a fiduciary capacity for another.~~

~~(9) Fiscal year. -- Defined in section 441(e) of the Code.~~

~~(10) Individual. -- A natural person.~~

~~(11) Miscellaneous payroll period. -- A payroll period other than a daily, weekly, biweekly, semimonthly,~~

~~monthly, quarterly, semiannual, or annual payroll period.~~

~~(12) Payroll period. -- A period for which an employer ordinarily pays wages to an employee of the employer.~~

~~(13) Person. -- Defined in G.S. 105-228.90.~~

~~(14) Taxable year. -- Defined in section 441(b) of the Code.~~

~~(14a) Secretary. -- The Secretary of Revenue.~~

~~(15) Wages. -- The term has the same meaning as in section 3401 of the Code except it does not include either of the following:~~

~~a. Remuneration paid by a farmer for services performed on the farmer's farm in producing or harvesting agricultural products or in transporting the agricultural products to market.~~

~~b. The first thirty-five thousand dollars ($35,000) of severance wages paid to an employee during the taxable year as the result of the permanent closure of a manufacturing or processing plant.~~

"§ 105-163.2. ~~Withholding.~~ Employers must withhold taxes.

(a) Withholding Required. -- An employer shall deduct and withhold from the wages of each employee the State income taxes payable by the employee on the wages. For each payroll period, the employer shall withhold from the employee's wages an amount that would approximate the employee's income tax liability under Article 4 of this Chapter if the employer withheld the same amount from the employee's wages for each similar payroll period in a calendar year. In calculating an employee's anticipated income tax liability, the employer shall allow for the exemptions, deductions, and credits to which the employee is entitled under Article 4 of this Chapter. The amount of State income taxes withheld by an employer is held in trust for the Secretary.

(b) Withholding Tables -- The manner of withholding and the amount to be withheld shall be determined in accordance with tables and rules adopted by the Secretary. The withholding exemption allowed by these tables and rules shall, as nearly as possible, approximate the exemptions, deductions, and credits to which an employee would be entitled under Article 4 of this Chapter. The Secretary shall ~~cause to be prepared and shall~~ promulgate tables for computing amounts to be withheld with

respect to different rates of wages for different payroll periods applicable to the various combinations of exemptions to which an employee may be entitled and taking into account the appropriate standard deduction. The tables may provide for the same amount to be withheld within reasonable salary brackets or ranges so designed as to result in the withholding during a year of approximately the amount of an employee's indicated income tax liability for that year. The withholding of wages pursuant to and in accordance with these tables shall be deemed as a matter of law to constitute compliance with the provisions of subsection (a) of this section, notwithstanding any other provisions of this Article.

(c) Withholding If No Payroll Period. -- If wages are paid with respect to a period ~~which~~ that is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days, excluding Sundays and holidays, equal to the number of days in the period with respect to which such wages are ~~paid. (d) In~~ paid. In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the number of days, excluding Sundays and holidays, which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(d) Estimated Withholding. -- The Secretary may, by rule, authorize employers to estimate the wages to be paid to an employee during a calendar quarter, calculate the amount to be withheld for each period based on the estimated wages, and, upon payment of wages to the employee, adjust the withholding so that the amount actually withheld is the amount that would be required to be withheld if the employee's payroll period were quarterly.

(e) Alternatives to Tables. -- If the Secretary determines that use of the withholding tables would be impractical, would impose an unreasonable burden on an employer, or would produce substantially incorrect results, the Secretary may authorize or require an employer to use some other method of determining the amounts to be withheld under this Article. The alternative method authorized by the Secretary must reasonably approximate the predicted income tax liability of the affected employees. In addition, with the agreement of the employer and employee, the Secretary may authorize an employer to use an alternative method

that results in withholding of a greater amount than otherwise required under this section.

The Secretary's authorization of an alternative method is discretionary and may be cancelled at any time without advance notice if the Secretary finds that the method is being abused or is not resulting in the withholding of an amount reasonably approximating the predicted income tax liability of the affected employees. The Secretary shall give an employer written notice of any cancellation and the findings upon which the cancellation is based. The cancellation becomes effective upon the employer's receipt of this notice or on the third day after the notice was mailed to the employer, whichever occurs first. If the employer requests a hearing on the cancellation within 30 days after the cancellation, the Secretary shall grant a hearing. After a hearing, the Secretary's findings are conclusive.

~~(e) The Secretary may, by regulations, authorize employers:~~

~~(1) To estimate the wages which will be paid to any employee in any quarter of the calendar year;~~

~~(2) To determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid; and~~

~~(3) To deduct and withhold upon any payment of wages to such employee during such quarter such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount that would be required to be deducted and withheld during such quarter if the payroll period of the employee was quarterly.~~

~~(f) The Secretary is authorized in unusual circumstances wherein he finds that the use of the prescribed tables is impracticable or constitutes an unreasonable requirement of the employer to authorize such employer to use some other method of determining the amounts to be withheld under this Article, provided the amounts withheld under such other method will reasonably approximate the indicated income tax liability of his employees. Further, the Secretary may authorize an employer to use another method for determining the amounts to be withheld under the provisions of this Article from the wages or salaries of groups of employees or individual employees if the circumstances are such that the use of the tables would produce substantially incorrect results. Any authorization of the use of~~

~~a different method shall be subject to review and cancellation or alteration by the Secretary every twelfth month, and the Secretary may cancel such authorization or order an alteration of such method at any time upon a finding by him that such authorization is being abused or that such method is not resulting in the withholding of a sum reasonably approximating the indicated income tax liability of the employees, which finding may be made by the Secretary with or without notice or a hearing and shall be conclusive except as hereinafter provided. The Secretary shall notify the employer in writing of his finding and order thereon, and such notice shall be deemed to have been received by the employer on the third day after having been deposited in the mail and the employer shall thereafter abide by such order. Any employer feeling aggrieved by such order may thereafter apply for a hearing thereon before the Secretary, unless a hearing has been previously held, and upon such hearing the findings of the Secretary shall be deemed conclusive.~~

~~(g) The Secretary is authorized to provide by regulation, under such conditions and to such extent as he deems proper, for withholding in addition to that otherwise required under this section in cases in which the employer and the employee agree to such additional withholding. Such additional withholding shall for all purposes be treated as other withholding amounts required to be deducted and withheld under this Article.~~

~~(h) The act of compliance with any of the provisions of this Article by a nonresident employer shall not constitute an act in evidence of and shall not be deemed to be evidence that such nonresident is doing business in this State.~~

"§ 105-163.3. ~~Withholding in accordance with regulations.~~ Certain payers must withhold taxes.

(a) Requirement. -- Every payer shall deduct and withhold from compensation paid to a contractor the State income taxes payable by the contractor on the compensation as provided in this section. The amount of taxes to be withheld is four percent (4%) of the compensation paid to the contractor. The taxes a payer withholds are held in trust for the Secretary.

(b) Thresholds. -- For a payer that is an employer subject to the withholding requirement of G.S. 105-163.2, withholding is required under this section only if the total compensation the payer pays to the contractor during the calendar year exceeds six hundred dollars ($600.00). For other payers, withholding is required only if the total compensation the payer pays to the contractor during the calendar year exceeds ten thousand dollars ($10,000).

(c) Exemptions. -- The withholding requirement does not apply to the following:

(1) Compensation that is subject to the withholding requirement of G.S. 105-163.2.

(2) Compensation paid to an ordained or licensed member of the clergy.

(d) Returns; Due Date. -- A payer shall file a return with the Secretary on a form prepared by the Secretary and shall provide any information required by the Secretary. The return is due 15 days after the end of each month during which the payer pays compensation to a contractor. Withheld taxes are payable when the return is due. The Secretary may extend the time for filing the return or paying the tax as provided in G.S. 105-263.

(e) Annual Statement; Report to Secretary. -- A payer required to deduct and withhold from a contractor's compensation under this section shall furnish to the contractor duplicate copies of a written statement showing the following:

(1) The payer's name, address, and taxpayer identification number.

(2) The contractor's name, address, and taxpayer identification number.

(3) The total amount of compensation paid during the calendar year.

(4) The total amount deducted and withheld under this section during the calendar year.

This statement is due by January 31 following the calendar year or, if the contract is completed before the end of the calendar year, within 45 days after the payer's last payment of compensation to the contractor. The Secretary may require the payer to include additional information on the statement.

Each payer shall file with the Secretary an annual report that compiles the information contained in each of the payer's statements to contractors and any other information required by the Secretary. This report is due on the date prescribed by the Secretary and is in lieu of the information report required by G.S. 105-154.

(f) Records. -- If a payer does not withhold from payments to a nonresident corporation or a nonresident limited liability company because the entity has obtained a certificate of authority from the Secretary of State, the payer shall obtain from the entity its corporate identification number issued by the Secretary of State. If a payer does not withhold from payments to an individual because the individual is a resident, the payer shall obtain the individual's address and social security number.

If a payer does not withhold from a partnership because the partnership has a permanent place of business in this State, the payer shall obtain the partnership's address and taxpayer identification number. The payer shall retain this information with its records.

~~The manner of withholding and the amount to be deducted and withheld under G.S. 105-163.2 shall be determined in accordance with tables, rules, and regulations adopted by the Secretary. The withholding exemption allowed by these tables, rules, and regulations shall, as nearly as possible, approximate the exemptions, deductions, and credits to which an employee would be entitled under Article 4 of this Chapter.~~

"§ 105-163.4. Withholding does not create nexus.

A nonresident withholding agent's act in compliance with this Article does not in itself constitute evidence that the nonresident is doing business in this State.

~~**No withholding from reimbursement for expenses.**~~

~~The amount an employer pays an employee as reimbursement for ordinary and necessary expenses incurred by the employee on behalf of the employer and in the furtherance of the business of the employer is not wages and is not subject to withholding under this Article.~~

"§ 105-163.5. ~~Exemptions~~ Employee exemptions allowable; certificates.

(a) An employee receiving wages ~~shall be~~ is entitled to the exemptions for which ~~such~~ the employee qualifies under ~~the provisions of~~ Article 4 of this Chapter.

(b) Every employee shall, ~~on or before January 1, 1960, or~~ at the time of commencing employment, ~~whichever is later,~~ furnish his or her employer with a signed withholding exemption certificate informing the employer of the exemptions the employee claims, which in no event shall exceed the amount of exemptions to which the employee is entitled under the ~~Code; but, in the event that~~ Code. If the employee fails to file the exemption certificate the employer, in computing amounts to be withheld from the employee's wages, shall allow the employee the exemption accorded a single person with no dependents.

(c) Withholding exemption certificates shall take effect as of the beginning of the first payroll period ~~which~~ that ends on or after the date on which ~~such~~ the certificate is furnished, or if payment of wages is made without regard to a payroll period, then ~~such~~ the certificate shall take effect as of the beginning of the miscellaneous payroll period for which the first payment of wages is made on or after the date on which ~~such~~ the certificate is

~~furnished; provided, that certificates furnished before January 1, 1960, shall be deemed to have been furnished on that date.~~ furnished.

(d) If, on any day during the calendar year, the amount of withholding exemptions to which the employee is entitled is less than the amount of withholding exemptions claimed by the employee on the withholding exemption certificate then in effect with respect to ~~him,~~ the employee, the employee shall, within 10 days thereafter, furnish the employer with a new withholding exemption certificate ~~relating to~~ stating the amount of withholding exemptions which the employee then claims, which shall in no event exceed the amount to which ~~he~~ the employee is entitled on ~~such~~ that day. If, on any day during the calendar year, the amount of withholding exemptions to which the employee is entitled is greater than the amount of withholding exemptions claimed, the employee may furnish the employer with a new withholding exemption certificate ~~relating to~~ stating the amount of withholding exemptions which the employee then claims, which shall in no event exceed the amount to which ~~he~~ the employee is entitled on ~~such~~ that day.

(e) Withholding exemption certificates ~~shall be in such form and contain such information as the Secretary may prescribe, but, insofar~~ must be in the form and contain the information required by the Secretary. As far as practicable, the Secretary shall cause the form of ~~such~~ the certificates to be substantially similar to federal exemption certificates.

(f) In addition to any criminal penalty provided by law, if an individual furnishes his or her employer ~~with~~ an exemption certificate that contains information which has no reasonable basis and that results in a lesser amount of tax being withheld under this Article than would have been withheld if the individual had furnished reasonable information, the individual is subject to a penalty of fifty percent (50%) of the amount not properly withheld.

"**§ 105-163.6. When employer must file returns and pay withheld taxes.**

(a) General. -- A return is due quarterly or monthly as specified in this section. A return shall be filed with the Secretary on a form prepared by the Secretary, shall report any payments of withheld taxes made during the period covered by the return, and shall contain any other information required by the Secretary.

Withheld taxes are payable quarterly, monthly, or semiweekly, as specified in this section. If the Secretary finds that

collection of the amount of taxes this Article requires an employer to withhold is in jeopardy, the Secretary may require the employer to file a return or pay withheld taxes at a time other than that specified in this section.

(b) Quarterly. -- An employer who withholds an average of less than five hundred dollars ($500.00) of State income taxes from wages each month shall file a return and pay the withheld taxes on a quarterly basis. A quarterly return covers a calendar quarter and is due by the last day of the month following the end of the quarter.

(c) Monthly. -- An employer who withholds an average of at least five hundred dollars ($500.00) but less than two thousand dollars ($2,000) from wages each month shall file a return and pay the withheld taxes on a monthly basis. A return for the months of January through November is due by the 15th day of the month following the end of the month covered by the return. A return for the month of December is due the following January 31.

(d) Semiweekly. -- An employer who withholds an average of at least two thousand dollars ($2,000) of State income taxes from wages each month shall file a return by the date set under the Code for filing a return for federal employment taxes attributable to the same wages and shall pay the withheld State taxes by the date set under the Code for depositing or paying federal employment taxes attributable to the same wages. The date set by the Code for depositing or paying federal employment taxes shall be determined without regard to § 6302(g) of the Code.

An extension of time granted to file a return for federal employment taxes attributable to wages is an automatic extension of time for filing a return for State income taxes withheld from the same wages, and an extension of time granted to pay federal employment taxes attributable to wages is an automatic extension of time for paying State income taxes withheld from the same wages. An employer who pays withheld State income taxes under this subsection is not subject to interest on or penalties for a shortfall in the amount due if the employer would not be subject to a failure-to-deposit penalty had the shortfall occurred in a deposit of federal employment taxes attributable to the same wages and the employer pays the shortfall by the date the employer would have to deposit a shortfall in the federal employment taxes.

(e) Category. -- The Secretary shall monitor the amount of taxes withheld by an employer or estimate the amount of taxes to be withheld by a new employer and shall direct each employer to pay withheld taxes in accordance with the appropriate schedule.

An employer shall file a return and pay withheld taxes in accordance with the Secretary's direction until notified in writing to file and pay under a different schedule.

"§ 105-163.7. Statement to employees; information to Secretary.

(a) Every employer required to deduct and withhold from an employee's wages under G.S. 105-163.2 shall furnish to ~~each such~~ the employee in respect to the remuneration paid by ~~such~~ the employer to such employee during the calendar year, on or before January 31 of the succeeding year, or, if ~~his~~ the employment is terminated before the close of ~~such~~ the calendar year, within 30 days ~~from~~ after the date on which the last payment of remuneration is made, duplicate copies of a written statement showing the following:

(1) The ~~name of such person;~~ employer's name, address, and taxpayer identification number.

(2) The ~~name of the employee and his~~ employee's name and social security ~~account number;~~ number.

(3) The total amount of ~~wages;~~ wages.

(4) The total amount deducted and withheld under G.S. 105-163.2.

(b) The Secretary may require an employer to include information not listed in subsection (a) on the employer's written statement to an employee and to file the statement at a time not required by subsection (a). Every employer shall file an annual report with the Secretary that contains the information given on each of the employer's written statements to an employee and other information required by the Secretary. The annual report is due on the same date the employer's federal information return of federal income taxes withheld from wages is due under the Code. The report required by this subsection is in lieu of the report required by G.S. 105-154.

(c) An employer who is required to file an annual report under subsection (b) of this section must report to the Secretary the following information concerning compliance with Article 1 of Chapter 97 of the General Statutes, the Workers' Compensation Act:

(1) Whether the employer is required to maintain insurance or qualify as a self-insured employer under the provisions of G.S. 97-93.

(2) Whether the employer is insured, self-insured through a group, or individually self-insured.

(3) The name of the employer's workers' compensation insurance carrier and the number and expiration

date of the insurance policy if the employer has workers' compensation insurance.

(4) The name of the self-insured group, the group's third-party administrator, and the group's or employer's self-insured code number used by the Department of Insurance, if the employer is a member of a self-insured group.

(5) The name of the employer's third-party administrator and the employer's self-insured code number used by the Department of Insurance, if the employer is individually self-insured.

(6) Whether any information reported to the Secretary on a previous return has changed.

The Secretary must compile the information concerning workers' compensation reported by employers on an annual report and must give the compiled data to the Industrial Commission.

"§ 105-163.8. Liability of ~~employer~~ withholding agents and others.

(a) ~~Employer. An employer~~ Withholding Agents. -- A withholding agent who withholds the proper amount of income taxes under ~~G.S. 105-163.2~~ this Article and pays the withheld amount to the Secretary is not liable to any person for the amount paid. ~~An employer~~ A withholding agent who fails to withhold the proper amount of income taxes or pay the amount withheld to the Secretary is liable for the amount of tax not withheld or not paid. ~~An employer~~ A withholding agent who fails to withhold the amount of income taxes required by this Article or who fails to pay withheld taxes by the due date for paying the taxes is subject to ~~a penalty equal to twenty-five percent (25%) of the amount of taxes not withheld or not timely paid to the Secretary.~~ the penalties provided in Article 9 of this Chapter.

(b) Others. -- A person who has a duty to deduct, account for, or pay taxes required to be withheld under ~~G.S. 105-163.2~~ this Article and who fails to do so is liable for the amount of tax not deducted, not accounted for, or not paid.

"§ 105-163.9. Refund of overpayment to ~~employer.~~ withholding agent.

~~An employer~~ A withholding agent who pays the Secretary more under this Article than the Article requires the ~~employer~~ agent to pay may obtain a refund of the overpayment by filing an application for a refund with the Secretary. No refund is allowed, however, if the ~~employer~~ withholding agent withheld the amount of the overpayment from the ~~wages of the employer's employees.~~ wages or compensation of the agent's employees or

contractors. ~~An employer~~ A withholding agent must file an application for a refund within the time period set in G.S. 105-266. Interest accrues on a refund as provided in G.S. 105-266.

"§ 105-163.10. Withheld amounts credited to ~~individual~~ taxpayer for calendar year.

The amount deducted and withheld under ~~G.S. 105-163.2~~ this Article during any calendar year from the wages or compensation of ~~any~~ an individual shall be allowed as a credit to that individual against the tax imposed by ~~G.S. 105-134.2~~ Article 4 of this Chapter for taxable years beginning in that calendar year. The amount deducted and withheld under this Article during any calendar year from the compensation of a nonresident entity shall be allowed as a credit to that entity against the tax imposed by Article 4 of this Chapter for taxable years beginning in that calendar year. If the nonresident entity is a pass-through entity, the entity shall pass through and allocate to each owner the owner's share of the credit.

If more than one taxable year begins in ~~that calendar year~~ the calendar year during which the withholding occurred, the amount shall be allowed as a credit against the tax for the last taxable year so beginning. To obtain the credit allowed in this section, the individual or nonresident entity must file with the Secretary one copy of the withholding statement required by G.S. 105-163.3 or G.S. 105-163.7 and any other information the Secretary requires.

"§ 105-163.11 to 105-163.14. Repealed by Session Laws 1985, c. 443, s. 1, effective for taxable years beginning on or after January 1, 1986.

"§ 105-163.15. Failure by individual to pay estimated income tax; penalty.

(a) In the case of any underpayment of the estimated tax by an individual, there shall be added to the tax imposed under Article 4 for the taxable year an amount determined by applying the applicable annual rate established under G.S. 105-241.1(i) to the amount of the underpayment for the period of the underpayment.

(b) For purposes of subsection (a), the amount of the underpayment shall be the excess of the required installment, over the amount, if any, of the installment paid on or before the due date for the installment. The period of the underpayment shall run from the due date for the installment to whichever of the following dates is the earlier: (i) the fifteenth day of the fourth month following the close of the taxable year, or (ii) with respect to any portion of the underpayment, the date on

which such portion is paid. A payment of estimated tax shall be credited against unpaid required installments in the order in which such installments are required to be paid.

(c) For purposes of this section there shall be four required installments for each taxable year with the time for payment of the installments as follows:

(1) First installment -- April 15 of taxable year;

(2) Second installment -- June 15 of taxable year;

(3) Third installment -- September 15 of taxable year; and

(4) Fourth installment -- January 15 of following taxable year.

(d) Except as provided in subsection (e), the amount of any required installment shall be twenty-five percent (25%) of the required annual payment. The term "required annual payment" means the lesser of:

(1) Ninety percent (90%) of the tax shown on the return for the taxable year, or, if no return is filed, ninety percent (90%) of the tax for that year; or

(2) One hundred percent (100%) of the tax shown on the return of the individual for the preceding taxable year, if the preceding taxable year was a taxable year of 12 months and the individual filed a return for that year.

(e) In the case of any required installment, if the individual establishes that the annualized income installment is less than the amount determined under subsection (d), the amount of the required installment shall be the annualized income installment, and any reduction in a required installment resulting from the application of this subsection shall be recaptured by increasing the amount of the next required installment determined under subsection (d) by the amount of the reduction and by increasing subsequent required installments to the extent that the reduction has not previously been recaptured.

In the case of any required installment, the annualized income installment is the excess, if any, of (i) an amount equal to the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the taxable income for months in the taxable year ending before the due date for the installment, over (ii) the aggregate amount of any prior required installments for the taxable year. The taxable income shall be placed on an annualized basis under rules prescribed by the Secretary. The applicable percentages for the required installments are as follows:

(1) First installment -- twenty-two and one-half percent (22.5%);
(2) Second installment -- forty-five percent (45%);
(3) Third installment -- sixty-seven and one-half percent (67.5%); and
(4) Fourth installment -- ninety percent (90%).

(f) No addition to the tax shall be imposed under subsection (a) if the tax shown on the return for the taxable year reduced by the tax withheld under ~~Article 4A~~ this Article is less than the amount set in section 6654(e) of the Code or if the individual did not have any liability for tax under Division II of Article 4 for the preceding taxable year.

(g) For purposes of this section, the term "tax" means the tax imposed by Division II of Article 4 minus the credits against the tax allowed by ~~Article 4.~~ this Chapter other than the credit allowed by this Article. The amount of the credit allowed under ~~Article 4A~~ this Article for withheld income tax for the taxable year is considered a payment of estimated tax, and an equal part of that amount is considered to have been paid on each due date of the taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld, in which case the amounts so withheld are considered payments of estimated tax on the dates on which ~~such~~ the amounts were actually withheld.

(h) If, on or before January 31 of the following taxable year, the taxpayer files a return for the taxable year and pays in full the amount computed on the return as payable, no addition to tax shall be imposed under subsection (a) with respect to any underpayment of the fourth required installment for the taxable year.

(i) Notwithstanding the other provisions of this section, an individual who is a farmer or fisherman for a taxable year is required to make only one installment payment of tax for that year. This installment is due on or before January 15 of the following taxable year but may be paid without penalty or interest on or before March 1 of that year. The amount of the installment payment shall be the lesser of:
(1) Sixty-six and two-thirds percent (66 2/3%) of the tax shown on the return for the taxable year, or, if no return is filed, sixty-six and two-thirds percent (66 2/3%) of the tax for that year; or
(2) One hundred percent (100%) of the tax shown on the return of the individual for the preceding taxable year, if the preceding taxable year was a taxable

year of 12 months and the individual filed a return for that year.

An individual is a farmer or fisherman for any taxable year if the individual's gross income from farming or fishing, including oyster farming, for the taxable year is at least sixty-six and two-thirds percent (66 2/3%) of the total gross income from all sources for the taxable year, or the individual's gross income from farming or fishing, including oyster farming, shown on the return of the individual for the preceding taxable year is at least sixty-six and two-thirds percent (66 2/3%) of the total gross income from all sources shown on the return.

(j) In applying this section to a taxable year beginning on any date other than January 1, there shall be substituted, for the months specified in this section, the months that correspond thereto. This section shall be applied to taxable years of less than 12 months in accordance with rules prescribed by the Secretary.

(k) This section shall not apply to any estate or trust.

"**§ 105-163.16. Overpayment refunded.**

If the amount of wages or compensation withheld at the source under ~~G.S. 105-163.2~~ this Article exceeds the tax imposed by Article 4 of this Chapter against which the withheld tax is credited under G.S. 105-163.10, the excess is considered an overpayment by the ~~employee.~~ employee or contractor. If the amount of estimated tax paid under G.S. 105-163.15 exceeds the taxes imposed by Article 4 of this Chapter against which the estimated tax is credited under the provisions of this Article, the excess is considered an overpayment by the taxpayer. An overpayment shall be refunded as provided in Article 9 of this Chapter.

~~"§ 105-163.17. Administration.~~

~~The provisions of Article 9 of this Chapter apply to the amount of State income taxes this Article requires an employer to withhold and pay to the Secretary.~~

~~"§ 105-163.18. Rules and regulations.~~

~~The Secretary is hereby authorized to prescribe forms and make all rules and regulations which he deems necessary in order to achieve effective and efficient enforcement of this Article.~~

"**§ 105-163.19 to 105-163.21.** Repealed by Session Laws 1967, c. 1110, s. 4.

"**§ 105-163.22. Reciprocity.**

The Secretary ~~of Revenue~~ may, with the approval of the Attorney General, enter into agreements with the taxing authorities of states having income tax withholding statutes with

such agreements to govern the amounts to be withheld from the wages and salaries of residents of such other state or states under the provisions of this Article when such other state or states grant similar treatment to the residents of this State. Such agreements may provide for recognition of the anticipated tax credits allowed under the provisions of G.S. 105-151 in determining the amounts to be withheld.

"**§ 105-163.23. Withholding from federal employees.**

The Secretary ~~of Revenue is hereby~~ is designated as the proper official to make request for and enter into agreements with the Secretary of the Treasury of the United States to provide for the compliance with this Article by the head of each department or agency of the United States in withholding of State income taxes from wages of federal employees and paying the same to this State. The Secretary is ~~hereby~~ authorized, ~~empowered~~ empowered, and directed to ~~make request for~~ request and enter into ~~such~~ these agreements.

"**§ 105-163.24. Construction of Article.**

This Article shall be liberally construed in pari materia with Article 4 of this Chapter to the end that taxes levied by Article 4 shall be collected with respect to wages and compensation by withholding ~~from wages by employers~~ agents' withholding of the appropriate amounts ~~herein provided for~~ and by individuals' payments in installments ~~by individuals~~ of income tax with respect to income ~~other than wages.~~ not subject to withholding."

Section 3. Section 1 of this act is effective when this act becomes law. The remainder of this act becomes effective January 1, 1998.

Explanation – Withholding for Nonresidents
Legislative Proposal 1

This proposal would require withholding from compensation paid to nonresident individuals and nonresident entities for personal services performed in North Carolina, effective January 1, 1998. It was suggested by the Department of Revenue.

North Carolina taxes the income of its residents and also that income derived by nonresidents from businesses, trades, and occupations carried on in this State. Most other states that have an income tax tax nonresidents' income in this way. Like North Carolina, these states generally give their residents a credit for income tax paid to other states on income derived from those states.

Many nonresidents who derive income from North Carolina do not pay the North Carolina tax due on this income. This problem is particularly troublesome with respect to single event performers such as athletes or entertainers who may be paid large amounts for their work in North Carolina. It is difficult, expensive, and inefficient for the Department of Revenue to trace and pursue these nonresidents who do not pay the tax they owe.

This proposal will impose a withholding requirement on payments made to nonresidents for services performed in this state. This requirement is similar to the current law which requires employers to withhold taxes from wages paid their employees. The new requirement will not apply to wages, which are already covered under the current law; the new requirement applies to payments to independent contractors.

Examples of nonresidents targeted by the proposed withholding requirement are musicians, actors, and individual athletes. Because these individuals may be paid through a partnership, limited liability company, or corporation that does not have ties to this State, the withholding requirement will apply to payments to these entities as well. If the entity is registered in this State or maintains a permanent office in this State, payments to it are not subject to withholding. Payments it makes to nonresidents for their services will, however, be subject to withholding, under either the new requirement for contract payments or the current requirement for wages.

Under this proposal, a person or entity who pays a nonresident for personal services in this State will be required to withhold 4% of the payment and deposit the withheld taxes with the Department of Revenue. Private individuals and others not already subject to the employer withholding requirement do not have to withhold unless the total amount to be paid to the nonresident exceeds $10,000. For payers already withholding as employers, the new withholding requirement applies if the total amount to be paid to the nonresident exceeds $600.

The withholding agent must register with the Department of Revenue. Withheld taxes are due 15 days after the end of the month in which the withholding agent paid the nonresident. As is the case with employers who withhold from employees' wages, the withholding agent will be required to give each nonresident a statement similar to a W-2 form in January and to provide a compilation of these statements to the Department of Revenue. Filing these documents relieves the agent of the existing information reporting requirement of G.S. 105-154.

The withheld taxes will be credited to the nonresident individual or entity from which they were withheld. If the entity is a pass-through entity such as a partnership, Subchapter S corporation, or limited liability company, the credit will pass through to the partners or other owners of the entity. The nonresident will receive credit for the withheld taxes by filing a North Carolina income tax return; any excess will be refunded to the taxpayer.

A number of other states have instituted withholding programs and special audit programs to close the loophole that allows nonresidents to avoid paying state income taxes they owe. California, Connecticut, Minnesota, New Jersey, and South Carolina have withholding requirements. Michigan, Missouri, and New York have special audit programs.

Fiscal Report
Fiscal Research Division
December 30, 1996

Proposal 1: Withholding for Nonresidents Performing Personal Services

Summary: The proposed bill requires North Carolinians to withhold 4% of the payment owed nonresidents for services rendered in the state. If you currently withhold as an employer, any payment to a nonresident exceeding $600 would require withholding. Persons not already subject to employer withholding requirements would withhold from nonresident payments exceeding $10,000. If the nonresident is a corporation or a LLC and it registers with the Secretary of State it will not be subject to withholding.

Effective Date: Section 1 is effective upon ratification; the remainder of the act is effective January 1, 1998.

Fiscal Effect:

The Department of Revenue requests this legislation to increase the collection of income taxes owed by nonresident companies and individuals. Current law already requires withholding from nonresident professional team athletes. With the adoption of an administrative rule in November 1995, the Department requires professional athletic teams to determine the portion of an athlete's income subject to North Carolina tax and withhold 7.75% of the athlete's North Carolina source income.

Nonresident withholding is being done by a handful of states such as California, Connecticut, Minnesota, Nebraska, and South Carolina. The nonresident withholding laws in these states are examined in more detail below.

I. OTHER STATES

SOUTH CAROLINA

South Carolina is the only Southeastern state with nonresident withholding. (It should be noted that Florida has no individual income tax and Tennesee's individual income tax is limited to dividends and interest income only.) South Carolina requires its citizens to withhold 2% of each payment to a nonresident when the contract exceeds $10,000. The person hiring or contracting with a nonresident can be exempted from withholding if the nonresident registers with the Department of Revenue or the Secretary of State. By registering, the nonresident agrees to be subject to the jurisdiction of the Department of

Revenue and the courts of the state. The nonresident must give an affidavit of registration to the person or company hiring or contracting with them.

South Carolina also requires withholding of nonresident rents and royalties that exceed $1,200 a year. The rate is 5% for corporations and 7% if not a corporation. The registration option is also available for this withholding law.

South Carolina set the withholding amount at $10,000 to avoid collection efforts on small contracts. The 2% rate allows for the deduction of expenses while doing business in the state. When the rate was set it was 1/3 of the state tax rate. The Department of Revenue is aggressive in enforcing its withholding law by sending letters to late filers, using out of state collection agencies, and barring delinquent firms from seeking state contracts. Companies failing to pay their taxes lose their withholding exemption.

Nonresident withholding earned the state $10.64 million in 1994-95 and $13.06 in 1995-96. These figures do not account for the tax paid by nonresidents filing normal tax returns or quarterly estimated payments. Since the law has been effect for at least 20 years, many companies have chosen to register rather than withhold. There is no estimate of the net revenue gained by South Carolina due to this law.

CALIFORNIA

California requires 7% withholding from payments to nonresidents which exceed $1,500 during the calendar year. Payments subject to withholding include rents, royalties, prizes and winnings, premiums, annuities, emoluments, compensation for services, partnership income or gains, and other fixed or determinable annual or periodic gains, profits, and income with a California source. The nonresident may request a waiver or reduced rate of withholding from the Franchise Tax Board when the 7% withholding rate results in significant over-withholding. To obtain a reduced rate or waiver, the nonresident must provide an income statement to the Board.

CONNECTICUT

Connecticut has a 4.5% withholding rate for nonresident payments that exceed $1,500 in a calendar year. A nonresident may apply to the Department to reduce the amount withheld by filing a list of expenses to be subtracted from taxable income. The nonresident may also apply for a waiver from withholding if they show they have a satisfactory history of filing Connecticut returns. For performers, the Department of Revenue has a database that tracks when a performance has taken place in the state and how much was paid the group.

NEBRASKA

Nebraska's withholding law covers nonresident individuals performing personal services such as consultants, entertainers, performers, jockeys, public speakers, or those providing

professional services. If the payer for these services currently withholds Nebraska tax as an employer, then any payment to a nonresident exceeding $600 must be subject to withholding. If the payer is not currently subject to withholding, then payments to nonresidents exceeding $5,000 is subject to withholding. Nonresidents are allowed to deduct ordinary and necessary business expenses from their payment before withholding, but the expenses must not exceed 50% of the payment. The tax rate is 4% of the net payment if less than $28,000 and 6% of the net payment if greater than $28,000. Revenue officials had no estimate of revenue earned from withholding.

Nebraska also has a Nonresident Contractor Program that requires all nonresident contractors to register with the Department of Revenue and pay a $25 permit fee. When the nonresident works in the state it pays a $25 fee to register each contract it is awarded that exceeds $2,500. It must then must file a bond or other security with the Department equal to 10% of the contract price up to $100,000 plus 5% of the contract price in excess of $100,000. When the project is complete the nonresident files a Nebraska Bond Clearance Request that shows all state and local taxes have been paid.

MINNESOTA

Minnesota has a 7% withholding on self-employed individuals earning more than $700 who are not residents of Minnesota, Wisconsin, Michigan, or North Dakota. The withholding is on the net payment after expenses are deducted. For entertainers, Minnesota charges a 2% tax on compensation greater than $2,000. Entertainers include athletes, public speakers, dancers, musicians, comedians, singers, and visiting professors for non-credit courses. Again the states of Wisconsin, North Dakota and Michigan are exempted.

II. TAX IMPACT

The proposed bill would increase General Fund revenues from withholding, from corporate registration fees with the Secretary of State ($200 for each foreign corporation), and from increased collections from registered firms now complying with state tax law (Revenue will be better able to track these firms). The revenue impact is unknown at this time due to the lack of data on revenue earned by nonresident companies operating in the state. Some industries are examined below to gauge the potential revenue gains from nonresident withholding.

GENERAL CONTRACTORS

In 1995, the North Carolina Licensing Board for General Contractors had 1,765 out of state companies licensed to work in the state. These firms sought licensing to work on projects greater than $30,000 in buildings, highways, public utilities, grading, and improvement of structures. The majority of these firms are from southeastern states such as South Carolina (426), Georgia (205), Virginia (174), Tennessee (155), and Florida

(152). However, the Licensing Board stated that other contractors work in the state without a license because of the contract size (< $30,000) or they are doing federal jobs.

If it is assumed that each licensed nonresident contractor earned $100,000 in North Carolina in 1995, what would the state from the proposed withholding law? Assuming these 1,765 firms paid no income tax to the state that year, the 4% withholding on the $100,000 contract payments would have yielded $7.06 million in 1995.

PROFESSIONAL GOLF

Passage of this bill would require professional golf tournaments to withhold payment from nonresident golfers. By scanning residence information from the various golf associations, it appeared many of the golfers lived in Florida (no income tax), California and Texas (no income tax). If this requirement were in effect in 1996, the state would have earned $243,764 from nonresidents in the following tournaments:

PGA	Greater Greensboro Classic	$1,800,000
LPGA	Fieldcrest Cannon Classic*	449,142
LPGA	U.S. Women's Open*	1,180,336
Senior PGA	Paine Webber Invitational	800,000
Senior PGA	Vantage Championship	1,500,000
Nike Tour	Carolina Classic	196,935
Hooters Tour	Charlotte*	94,631
Hooters Tour	Fayetteville*	73,058
		$6,094,102

*Known N. C. residents were deducted from winnings.

NASCAR

Most of the NASCAR race winnings in North Carolina are already being taxed because 32 racing teams are based in the state. Withholding 4% of the prize money earned by nonresident Winston Cup racers in 1996 (shown below) would earn the state $57,910.

Winston Cup	GM Goodwrench 400	$287,780
Winston Cup	Tyson/Holly Farms 400	178,190
Winston Cup	First Union 400	194,580
Winston Cup	Coca Cola 600	286,030
Winston Cup	UAW/GM Teamwork 500	274,085
Winston Cup	AC-Delco 400	227,075
		$1,447,740

Information was not available for all Busch and Craftsman racing teams, but known state resident winnings were subtracted from the race purses below. These races in 1996 would have yielded a maximum withholding of $47,561.

Busch Grand Natl.	Red Dog 300	188,495
Busch Grand Natl	All Pro Bumper to Bumper 300	276,245
Busch Grand Natl	AC-Delco 200	191,610
Busch Grand Natl	Sun Drop 400	125,335
Busch Grand Natl	Goodwrench 200	228,205
Craftsman Truck	Lowe's 250	179,140
		$1,189,030

The total expected withholding from NASCAR events in 1996 would have been $105,471.

CONCERTS

Revenue information for 1996 was obtained from two major venues and one major concert promoter. To estimate the withholding amount for concert acts, gross revenues must be reduced by the state gross receipts tax, local taxes, personnel expenses such as ticket sales and security, facility leases, and promotional expenses. One promoter estimated the entertainer's check would be about 60% of the gross revenues. Of course the artist must then pay his or her expenses to produce the show.

The following gross revenues are for 1996. Walnut Creek and Cellar Door are actual, but Blockbuster is an estimate.

Walnut Creek (Raleigh)	$7,542,000	
Blockbuster (Charlotte)	5,028,000	
Cellar Door (NC concerts)	1,639,000	
	$14,209,000	X 60% = $8,525,400
	$8,525,400	X 4% withholding = $341,016

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 2
97-RBX-010
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Update IRC Reference. (Public)

Sponsors: Representatives Neely, Blue, Cansler, Capps, Church, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-228.90(b)(1a) reads as rewritten:

"(1a) Code. -- The Internal Revenue Code as enacted as of ~~March 20, 1996,~~ January 1, 1997, including any provisions enacted as of that date which become effective either before or after that date."

Section 2. Notwithstanding Section 1 of this bill, amendments to sections 101(b), 104, and 877 of the Internal Revenue Code as enacted as of January 1, 1997, and any other amendments to the Internal Revenue Code enacted in 1996 that increase North Carolina taxable income for the tax year 1996, become effective for taxable years beginning on or after January 1, 1997.

Section 3. This act is effective when it becomes law.

Explanation -- Update IRC Reference
Legislative Proposal 2

This proposal rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from March 20, 1996, to January 1, 1997. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law. The proposal provides that the federal tax law changes that could increase an individual's North Carolina taxable income for the 1996 tax year will not become effective until January 1, 1997. Under Article 1, Sec. 16 of the North Carolina Constitution, the legislature cannot pass a law that will retroactively increase the tax liability of an individual. There are a few provisions in the federal tax law changes that could increase taxable income for the 1996 tax year. Since this proposal cannot be acted upon until the 1997 General Assembly convenes, theses changes must have a delayed effective date.

Congress passed four acts that, taken collectively, represent the broadest series of legislative changes affecting the Internal Revenue Code since it was recodified as part of the Tax Reform Act of 1986. The tax law changes are contained in the Small Business Job Protection Act, the Health Insurance Portability and Accountability Act, the Welfare Reform Act, and the Taxpayer Bill of Rights 2. Two business tax changes impact the General Fund proportionately more than the other tax changes: the Code Sec. 179 business expense deduction is increased from $17,500 to $25,000 over a period of 5 years and the amount a self-employed person may deduct for health insurance costs is increased from 30% to 80% over a period of 10 years.

The Small Business Job Protection Act made major changes to the S Corporation rules, introduced a new type of retirement plan (SIMPLE), and narrowed the exclusion for punitive damages received on account of personal injury or sickness. It also created a new adoption credit and exclusion and increased the amount a nonworking spouse could contribute to an IRA.

The Health Insurance Portability and Accountability Act also included several changes to the individual income tax laws. This Act creates a pilot test program for tax-favored medical savings accounts (MSAs) and adds two new exceptions to the 10% penalty for premature withdrawals from IRAs. It treats costs of long-term care services and some long-term care insurance premiums as medical expenses for itemized deduction purposes. The Act also allows an income tax exclusion for long-term care benefits to chronically ill insureds and extends the income tax exclusion for life insurance death benefits to benefits paid during life to the terminally ill. A chart detailing the major federal tax law changes that impact North Carolina taxable income is attached to this explanation.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been

updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this one. The answer to the question lies in both a policy decision and a potential legal restraint.

First, the policy reason for specifying a particular date is that, in light of the many changes made in federal tax law from year to year, the State may not want to adopt automatically federal changes, particularly when these changes result in large revenue losses. By pinning references to the Code to a certain date, the State ensures that it can examine any federal changes before making the changes effective for the State.

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Proposal 2
SHORT TITLE: Up-Date Internal Revenue Code
SPONSOR(S): Revenue Laws Study Committee; 11/26/96

FISCAL IMPACT: **Expenditures:** **Increase ()** **Decrease ( )**
Revenues: **Increase ()** **Decrease (x)**
No Impact ( )
No Estimate Available ( )

FUND AFFECTED: **General Fund ( )** **Highway Fund ( )** **Local Govt. ( )**
Other Funds ( )

BILL SUMMARY:
An up-date to the Internal Revenue Code is brought to the General Assembly annually as both a policy decision and a response to a legal restraint. The policy reason for specifying a particular date is that, in light of continuous changes made to the federal tax law, the State may not want to automatically adopt federal changes, particularly when they result in large revenue losses. The legal restraint involves Article V, Section 2(1) of the North Carolina State Constitution which states in pertinent part that the "power of taxation shall never be surrendered, suspended, or contracted away". A 1977, memorandum from the State Attorney General's Office to the Tax Research Division of the Department of Revenue concluded that a "statute which adopts by reference future amendments to the Internal Revenue code would be invalidated as an unconstitutional delegation of legislative powers".

Federal Legislation enacted by the Congress affecting the Internal Revenue Code is as follows:

Taxpayer Bill of Rights 2

Joint Return Contemporaneous Payment Requirement

The requirement that taxpayers who file separate returns pay the full tax liability when filing an amended joint return is repealed. In the past, taxpayers were required to pay the full amount of the joint tax liability at the time of filing an amended joint return or within three years of filing.

Effective for tax years beginning after July 30, 1996.

Small Business Job Protection Act of 1996

Increase in Small Business Expensing

The amount of tangible business property that may be expensed rather than depreciated over time is increased from $17,500 to $18,000 for tax year beginning in 1997, and increased every year there after until 2003 when the expense deduction will be $25,000.

Effective for tax years beginning after December 31, 1996.

Extension of Employer-Provided Education Assistance

The exclusion from an employer's gross income for employee educational assistance that expired for tax years beginning December 31, 1994, is retroactively extended. The maximum amount allowed under a qualified employer educational assistance program is $5,250 per employee. The exclusion is not available for expenses related to graduate courses beginning after June 30, 1996. The prohibited courses include any graduate level course leading to advanced academic or professional degrees.

The exclusion will expire effective for tax years beginning after May 31, 1997. Expenses paid for courses beginning before July 1, 1997, are excludable for tax year 1997.

Extension of Expired Provisions

- The 20% tax credit for research and experimentation that expired for amounts paid or incurred after June 30, 1995, is extended. Effective for amounts paid or incurred from July 1, 1996 through May 31, 1997.

- The orphan drug tax credit is extended for amounts paid between July 1, 1996, through May 31, 1997. Prior to January 1, 1995, a 50% tax credit was allowed for qualified clinical testing expenses incurred in testing certain drugs for rare diseases or conditions, generally referred to as "orphan drugs". Qualified expenses are cost incurred after the FDA has approved a drug for human testing but before it has been approved for sale.

- The special treatment for contributions of appreciated stock to private foundations is extended for contributions made between July 1, 1996, through May 31, 1997. Qualified appreciated stock is publicly traded stock that is capital gain property.

- The targeted jobs credit is replaced by the work opportunity credit and is effective for individuals starting work for an employer after September 31, 1996. The credit will not apply to individuals beginning work for an employer after September 30, 1997. The work opportunity credit has fewer targeted jobs, an increased minimum period in which a targeted group member must work for an employer, and a credit percent of 35% rather than 40% of the first $6,000 of wages paid to each targeted group member during the first year of employment.

S Corporation Simplification Provisions

- The number of eligible S corporation shareholders is increased form 35 to 75.

- Allows certain trust to hold S corporation stock. The beneficiaries of an "electing small business trust" may participate so long as they are individuals or estates and their interest in the trust must have been acquired by gift or bequest.

- An S corporation is allowed to own S or C subsidiaries. An S corporation is allowed to own 80% or more of the stock of a C corporation and can own a qualified subchapter S subsidiary in tax years beginning after 1996.

- Base adjustments for distributions made by an S corporation during the tax year are taken into account before applying the loss limitation for the year. As a result, distributions reduce the adjusted basis for determining the allowable loss for the year, but that loss does not reduce the adjusted basis for purposes of determining the tax status of the distribution. This provision provides the same tax treatment of distributions by S corporation during a (loss) year as allowed for partnerships.

All provisions effective for tax years beginning after December 31, 1996.

Lump-sum Distributions

The five year averaging option for lump-sum distributions from a qualified pension plan is repealed for individuals born after 1935; for tax years beginning after December 31, 1999. Individuals born before 1936 can elect a 10 year averaging option based on 1986 tax rates for a single person or a five year averaging method based on the single person tax rate in effect for the year in which the lump-sum distribution was taken. Individuals born after 1935 can elect a five year averaging if the distribution was made after they reached the age of 59 ½. (Under current law, the ten year averaging option is disallowed for this group.) After the effective date, the rules affecting those born before 1935 will not change. Those born after 1935 will not be allowed to average.

Effective for tax years beginning after December 31, 1999.

Special Employer-Provided Death Benefit Exclusion

The exclusion allowed the beneficiary or estate of a deceased employee to exclude up to $5,000 in benefits paid by or on behalf of an employer by reasons of the employee's death is repealed.

Effective for decedents dying after August 20, 1996.

Simplified Method of Determining Annuity Recovery Basis

The number of anticipated payment by age group used in calculating the nontaxable portion of each annuity payment from a qualified retirement plan, qualified annuity, or tax-sheltered annuity are increased. The nontaxable portion, of an annuity payment, is generally equal to the employee's total investment in the contract as of the annuity starting date, divided by the number of anticipated monthly payments, which are determined by reference to the age of the participant. The "new law" increases the number of monthly payment to be used in figuring the tax-free portion of each annuity payment. The age categories remain the same.

Effective with annuities commencing after November 17, 1996.

New Required Beginning Date for Distribution of Retirement Plans

Participants in qualified retirement plans, other than five-percent owners and IRA holders, are no longer required to begin receiving distributions from the fund after attaining the age of 70 ½ if they are still employed. Distributions must begin by April 1, of the calendar year following the later of : (1) the calendar year in which the participant reaches age 70 ½, or (2) the calendar year in which the employee retires.

Effective January 1, 1997

Deductible Contributions to Spousal IRAs

The maximum amount a married individual may contribute to a spousal IRA for a non-working spouse is increased from $250 to $2,000 a year. Prior to this change the maximum amount a couple filing jointly could contribute to an IRA was $2,250. Under the new law, a couple filing jointly can contribute $2,000 each for a total of $4,000.

Effective for tax years beginning after December 31, 1996

Adoption Assistance Credit and Expansion

Employees are allowed to exclude "qualified adoption expenses" from income if such amounts are paid or incurred by their employer. Qualified adoption expenses include adoption fees, court costs, attorney fees, and other expenses related to the legal adoption of an eligible child.

Effective for tax years beginning after December 31, 1996

Personal Injury or Sickness Damages Received; Limited Exclusion

The exclusion from income for damages received on account of personal injury or sickness is restricted to non-punitive damages. The exclusion from gross income only applies to damages received on account of a personal physical injury or physical sickness. Punitive damages awarded in wrongful death actions may be excluded from gross income where applicable State law only allows punitive damages to be awarded.

Effective with respect to amounts received after August 20, 1996, unless the amounts were received under a written binding agreement, court decree, or mediation award in effect on September 30, 1995.

Depreciation of Water Utility Property.

Under prior law, property used in the gathering, treating, and distribution of commercial water and municipal sewers systems was depreciated over 20 years using the 150% declining balance method. This method ensures a rate of depreciation that depreciated the asset exactly to salvage value over the period. The change allows for such property to be depreciated over a 25 year period using the straight-line method. The straight-line method is customarily used on assets where creeping obsolescence is the primary reason for a limited service life.

The act is effective for property placed in service June 12, 1996, other than property placed in service pursuant to a binding contract in effect before June 10, 1996.

Health Insurance Portability and Accountability Act of 1996

Medical Savings Accounts

Medical Savings Accounts are created for the purpose of defraying the un-reimbursed health care expenses on a tax-favored basis. A MSA is a trust or custodial account created exclusively for the benefit of the account holder and subject to rules similar to individual retirement accounts. Earnings on an MSA are not subject to tax, however, distributions for expenses other than medical are to be included as income and subject to penalty unless made after the participant reaches age 65, dies, or is disabled. Upon death, if the beneficiary is the individual's spouse, the spouse may continue the MSA as their own. Otherwise, the beneficiary must include the MSA balance in income in the year of death. If there is no beneficiary, the MSA balance is to be included on the final return of the decedent. In any case, no federal estate tax applies. Distributions from an MSA for medical expenses can be excluded from income.

Contributions made by an "eligible" employee or self-employed individual are deductible. Contributions made by an employer on behalf of an employee are excludable from the employee's income and wage for social security tax purposes. An "eligible" employee is one covered under an employer sponsored high deductible plan of a small employer and self-employed individuals. A high deductible health plan is one having an annual deductible of at least $1,500 and no more than $2,250 for individual coverage and at least $3,000 and no more than $4,500 for family coverage. An employer is a small employer if it employed, on average, no more than 50 employees during either the preceding or the second preceding years.

Effective for taxable years beginning on or after December 31, 1996.

Health Insurance Deduction Allowed to Self-employed Individuals

Self-employed individuals are allowed annual increases in health insurance premiums paid on behalf of self-employed individual, a spouse, and dependents. In 1993, the maximum deduction allowed was 25% of the qualified premiums and increased to 30% for tax years beginning after December 31, 1994.

The deduction is increased by the following amounts by tax year:

Tax Year	% Allowed Deduction
1997	40%
1998-2002	45
2003	50
2004	60
2005	70
2006	80

Medical Expenses Deduction for Long-term Care

Un-reimbursed amounts paid for qualified long-term care services are treated as medical care for purposes of the medical expense deduction. Eligible long-term care insurance premiums that do not exceed certain limits are deductible from gross income.

Effective for tax years beginning after December 31, 1996

Insurance Proceeds Received by the Chronically or Terminally Ill

The following are excluded from gross income:

- Proceeds received by the chronically ill from long-term care insurance.
- Proceeds received by the terminally ill from life insurance.

Effective for tax years beginning after December 13, 1996.

EFFECTIVE DATE: See specific act.

PRINCIPAL DEPARTMENT(S)/PROGRAM(S) AFFECTED:

Department of Revenue Personal Tax Division

FISCAL IMPACT

	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-00	FY 2000-01
REVENUES:					
GENERAL FUND	For Fiscal Impact See Spreadsheet				

ASSUMPTIONS AND METHODOLOGY:

Estimates prepared using federal and neighboring state computed impacts. The basic assumption used assumes that the State's cost will be .65% of the federal predicted cost. The State's personal income is approximately 2.5% of the U.S. total and the State's average tax rate is 25% of the federal.

SOURCES OF DATA:

Federal Tax Guide Reports
Taxpayer Bill of Rights 2
Small Business Job Protection Bill of 1996
Health Insurance Portability and Accountability Bill
Personal Responsibility and Work Opportunity Reconciliation Bill; 1996
1996 Tax Legislation: Law and Explanation

FISCAL RESEARCH DIVISION
733-4910
PREPARED BY: H. Warren Plonk
APPROVED BY:
DATE: January 9, 1996

Revenue Laws Study Commission
January 8, 1997

Internal Revenue Code Up-Date
Proposal 2

Federal Legislation Affecting NC.	Estimates ($ IN MILLIONS) Tax Year 1997	Tax Year 1998	Tax Year 1999	Tax Year 2000	Tax Year 2001
1. Small Business Expensing	($0.43)	($1.17)	($1.69)	($2.15)	($4.96)
2. Employer Educational Assistance	($6.00)	($6.70)			
3. S Corporation Simplification	($0.11)	($0.33)	($0.33)	($0.44)	($0.44)
4. Lump-Sum Distributions	$0.33	$0.66	$0.77	$0.66	$0.55
5. Employer Provided Death Benefits	$0.15	$0.45	$0.45	$0.56	$0.74
6. Simplify Annuity Recovery	($0.11)	($0.22)	($0.22)	($0.22)	($0.22)
7. Simplify Retirement Plans	($0.32)	($0.49)	($0.51)	($0.52)	($0.55)
8. Spousal IRAs	($0.37)	($1.10)	($1.20)	($1.26)	($1.34)
9. Personal Injury, Limit Exclusion	$0.33	$0.36	$0.40	$0.40	$0.42
10. Medical Savings Accounts	($0.77)	($1.62)	($1.72)	($1.85)	($2.00)
11. Increase Insurance Deduction; Self-Employed	($0.42)	($1.55)	($2.20)	($2.45)	($2.70)
12. Long Term Medical Care Expense Deduction	($0.70)	($4.34)	($4.20)	($4.30)	($4.83)
13. Accelerated Death Benefits	($0.06)	($0.70)	($1.07)	($1.40)	($1.70)
Total	($8.48)	($16.75)	($11.52)	($12.97)	($17.03)

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 3
97-LC-010B(1.1)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Conform Tax on Restored Income. (Public)

Sponsors: Representatives Cansler, Blue, Capps, Church, Neely, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CONFORM TO FEDERAL TAX TREATMENT OF INCOME RESTORED UNDER A CLAIM OF RIGHT.

The General Assembly of North Carolina enacts:

Section 1. Article 9 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-266.2. Refund of tax paid on substantial income later restored.**

This section applies to a taxpayer who is subject to the alternative tax under § 1341(a)(5) of the Code for the current taxable year because the taxpayer restored an item of income that had been included in the taxpayer's gross income for an earlier taxable year. For the purpose of Article 4 of this Chapter, the taxpayer is considered to have made a payment of tax for the current taxable year on the later of the date the return for the current taxable year was filed or the date the return was due to be filed. The amount of this payment of tax is (i) the amount the taxpayer's tax under Article 4 for the earlier taxable year was increased because the item of income was included in gross income for that year minus (ii) the amount the taxpayer's tax under Article 4 for the current taxable year was decreased because the item was deductible for that year. To the extent

this payment of tax creates an overpayment, the overpayment is refundable in accordance with G.S. 105-266."

Sec. 2. This act is effective for taxable years beginning on or after January 1, 1995.

Explanation - Conform Tax on Restored Income
Legislative Proposal 3

This proposal would conform North Carolina's income tax law to the Internal Revenue Code with respect to the tax treatment of a substantial amount of income that the taxpayer receives under a claim of right but later restores. The proposal is retroactive to the 1995 tax year to address a specific situation that has been brought to the committee's attention.

A taxpayer may receive a substantial amount of income in year one and pay tax on the income for that year. If, in year two or a later year, the taxpayer must give up some of that income, the taxpayer may deduct the amount given up, receiving a tax benefit to offset the tax paid on the income in year one. The taxpayer's income in year two may, however, be much smaller than the amount to be deducted. In this case, even with net loss deductions, the taxpayer would never offset enough income to receive credit for all the tax paid on the income in year one. The taxpayer is not allowed to file an amended return for year one to subtract the restored income because the taxpayer did in fact receive the income in year one. If the taxpayer had restored the income in year one rather than year two, the two events would have offset one another and there would have been no tax consequence.

The Internal Revenue Code provides relief in these cases if the amount restored is substantial and there is insufficient income in the later year to offset the deduction and thus reduce the taxpayer's tax by the amount it was increased in year one because of the inclusion of the amount later restored. Section 1341 of the Code gives the taxpayer, in effect, instead of a deduction in year two, credit for the amount by which the taxpayer's tax would have been reduced in year one if the restored amount had not been included in taxable income for that year. The credit is treated as a payment of tax made by the taxpayer, which can then be refunded.

North Carolina's individual and corporate income taxes piggyback the federal Code but do not conform to §1341 because of a technicality: §1341 is structured as an alternative tax rather than as a reduction in taxable income. Without a corresponding provision in the North Carolina income tax law, the taxpayer will end up paying tax on income the taxpayer later had to repay to another. Such a situation creates a windfall for the State and is perceived as unfair. The Department of Revenue does not oppose a conforming change to make the State law like the federal law. This proposal would adopt the federal approach, allowing a credit as if for tax paid in these situations.

The fiscal impact of this provision is expected to be small, because these situations arise rarely. They are sometimes seen with taxpayers who receive employer disability payments while an application for federal disability is pending. A federal disability application may take a year or two to process and, if benefits are approved retroactively, the taxpayer is usually required to refund the employer disability received in the meantime.

The case that was brought to the attention of the committee involved an individual who invented a formula for producing a chemical product and sold the formula to a manufacturer for nearly $2 million in 1994. The inventor's former employer sued the inventor claiming that the employer had licensing rights to the formula. The inventor settled the suit by paying the employer more than $400,000 of the $2 million sales proceeds in 1995. The inventor paid tax on the full $2 million in 1994; in 1995, the inventor had little income to offset the $400,000 deduction for the amount restored. Thus, the inventor will forfeit the more than $25,000 in North Carolina income tax paid on the remainder of the $400,000 in 1994 unless this proposal is enacted and is made retroactive to the 1995 tax year.

Proposal 3: Computation of Tax Where Taxpayer Restores Substantial Amount Held Under Claim of Right

Summary: This act will conform North Carolina's income tax law to the Internal Revenue Code (IRC 1341) with respect to the tax treatment of a substantial amount of income that a taxpayer receives one year, but refunds in another tax year.

Effective Date: The proposal is retroactive to the 1995 tax year.

Fiscal Effect:

This bill will produce a small annual revenue loss to the General Fund, but no data exists to calculate the exact fiscal impact. A spokesman for the Department of Revenue stated to the Committee that only a handful of cases each year would benefit from the law. Since the act is retroactive to 1995, there is a definite revenue loss of $25,000 in FY 97-98 for a refund to one taxpayer. (see bill explanation)

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 4
97-LC-006(1.1)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Automatic Annual Tax Reduction. (Public)

Sponsors: Representatives Shubert, Blue, Cansler, Capps, Church, and Neely.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO PROVIDE AUTOMATIC ANNUAL INCOME TAX REDUCTIONS AND TAX SIMPLICITY BY INDEXING THE STATE'S PERSONAL EXEMPTION AMOUNTS TO THE FEDERAL PERSONAL EXEMPTION AMOUNTS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-134.6(c)(4a) is repealed.

Section 2. The Department of Revenue shall draw from collections under Division II of Article 4 of Chapter 105 of the General Statutes for the 1997-98 fiscal year the amount needed to pay for the cost of printing and mailing new withholding tables required by this act, up to a maximum of one hundred sixteen thousand six hundred dollars ($116,600) for the 1997-98 fiscal year.

Section 2. This act is effective for taxable years beginning on or after January 1, 1998.

Explanation – Automatic Annual Income Tax Reductions

This proposal would provide automatic annual income tax reductions for individuals by increasing the State income tax personal exemptions to the amount of the federal personal exemptions, and providing that the exemption amounts would increase automatically each year at the same rate as the federal exemptions, based on the rate of inflation. The proposal would become effective beginning with the 1998 tax year. Increasing the personal exemption amounts reduces State income taxes for all individuals who pay income tax.

The State's personal exemption amounts were increased in 1995 in two stages, from $2,000 to $2,250 for the 1995 tax year and then to $2,500 for the 1996 tax year. The federal personal exemption amounts increase automatically each year to keep pace with inflation. The federal amount for the 1996 tax year is $2,550 and is expected to increase about $50 each year thereafter.

Increasing the State's personal exemption amounts to the federal amounts and allowing them to grow at the same pace in future years has three benefits. First, it reduces State personal income taxes for all North Carolina citizens who pay income tax. Families with children receive a larger tax reduction because a personal exemption deduction is allowed for the taxpayer, the spouse, and each dependent. Second, it allows the State tax structure to respond automatically to inflation. If the personal exemption amounts are not indexed to inflation, taxpayer's taxes increase automatically each year because the value of their income is inflated, even if, in real terms, they make the same amount of income or less income each year. Third, it greatly simplifies tax filing. North Carolina's individual income tax uses federal taxable income as the starting point for calculating North Carolina taxable income. As long as North Carolina's personal exemptions are not indexed to the federal amounts, every taxpayer must perform an extra calculation to adjust for the gap by adding back to federal taxable income the difference between the lower North Carolina personal exemption amount and the higher federal personal exemption amount.

Proposal 4 : Index Personal Exemptions

Summary: This act provides automatic annual income tax reductions and tax simplicity by indexing the state's personal exemption amounts to the federal personal exemption amounts.

Effective Date: Taxable years beginning on or after January 1, 1998.

Fiscal Effect:

($millions)

	FY 97-98	FY 98-99	FY 99-00	FY 00-01	FY 01-02
REVENUES:	($38.0)	($90.8)	($108.0)	($128.8)	($149.6)

The annualized cost of going from the current $2,500 state personal exemption amount ($2,000 for high income filers) to the $2,700 federal personal exemption amount in 1998 is estimated to be $84.4 million. This estimate is a product of the Personal Income Tax Model programmed by the Tax Research Division in the Department of Revenue. The model is based on individual income tax returns and is broken down by income class and filing status as shown below.

$Millions

Income Class (AGI)	Single	Married	Head of Household	All Filers
0	-	-	-	-
0<$10,.000	(0.80)	-	(0.50)	(1.30)
$10,000<$25,000	(3.90)	(3.10)	(13.90)	(20.90)
$25,000<$50,000	(4.30)	(10.70)	(8.30)	(23.30)
$50,000<$60,000	(0.60)	(3.80)	(0.80)	(5.20)
$60,000<$80,000	(2.60)	(7.70)	(0.70)	(11.00)
$80,000<100,000	(1.00)	(4.20)	(0.60)	(5.80)
$100,000<200,000	(0.90)	(13.40)	(0.50)	(14.80)
$200,000 or more	(0.10)	(2.00)	-	(2.10)
Total	**(14.20)**	**(44.90)**	**(25.30)**	**(84.40)**

Only 45% of the cost is reflected in the first fiscal year as employers adjust withholding tables for their employees (The rate is not 50% because there is some lag in changing withholding). It is then assumed the personal exemption rate will rise $50 each year. The Revenue model predicts the $50 increase will cost an additional $14.2 million in 1999 and $20.8 million in 2000. This memo assumes that each $50 rate increase in the years 2001 and 2002 will also cost $20.8 million.

The proposed bill eliminates the income cap on personal exemptions on the high income taxpayers shown below. If the income caps were kept, indexing to the federal rate in 1998 would cost $63.3 million on an annual rate (the FY 97-98 cost would be $28.5 million).

Married filing jointly	$100,000 or >	Head of Household	$80,000 or >
Married filing separately	$50,000 or >	Single	$60,000 or >

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S **D**

Legislative Proposal 5
97-LCX-008(1.1)
THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION

Short Title: Modify Setoff Debt Collection. (Public)

Sponsors: Senators Shaw, Cochrane, Cooper, Kerr, and Soles.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REVISE THE SETOFF DEBT COLLECTION ACT.

The General Assembly of North Carolina enacts:

Section 1. Chapter 105A of the General Statutes reads as rewritten:

"CHAPTER 105A.

"Setoff Debt Collection Act.

~~"ARTICLE 1.~~

~~"In General.~~

"§ 105A-1. Purposes.

The purpose of this ~~Article~~ Chapter is to establish as policy that all claimant agencies and the Department of Revenue shall cooperate in identifying debtors who owe money to the State through its various ~~claimant~~ agencies or to a local government and who qualify for refunds from the Department of Revenue. It is also the intent of this ~~Article~~ Chapter that procedures be established for setting off against any ~~such~~ refund the sum of any debt owed to the ~~State.~~ State or to a local government. Furthermore, it is the legislative intent that this ~~Article~~ Chapter be liberally construed so as to effectuate these purposes as far as legally and practically possible.

"§ 105A-2. Definitions.

The following definitions apply in this Chapter:

(1) Claimant agency. -- A State agency or a local agency acting through a clearinghouse or organization pursuant to G.S. 105A-3(b1).

(2) Debt. -- A liquidated sum due and owing a claimant agency that has accrued through contract, subrogation, tort, operation of law, or any other legal theory regardless of whether there is an outstanding judgment for the sum. The term includes sums collectible pursuant to Title IV, Part D of the Social Security Act.

(3) Debtor. -- An individual owing money to or having a delinquent account with any claimant agency which obligation has not been adjudicated satisfied by court order, set aside by court order, or discharged in bankruptcy.

(4) Department. -- The Department of Revenue.

(5) Reserved.

(6) Local agency. -- A county or municipality to the extent it is not a State agency as defined in this section.

(7) Net proceeds collected. -- Gross proceeds collected through setoff against a debtor's refund minus any collection assistance fee charged by the Department.

(8) Refund. -- An individual's North Carolina income tax refund.

(9) State agency. -- Any of the following:

a. The North Carolina Department of Human Resources when in the performance of its duties under the Medical Assistance Program enabled by Chapter 108A, Article 2, Part 6, and any county operating the same Program at the local level, when and only to the extent such a county is in the performance of Medical Assistance Program collection functions.

b. The North Carolina Department of Human Resources when in the performance of its duties under the Child Support Enforcement Program as enabled by Chapter 110, Article 9 and Title IV, Part D of the Social Security Act to obtain indemnification for past paid public assistance or to collect child support arrearages owed to an individual receiving

program services and any county operating the program at the local level, when and only to the extent that the county is engaged in the performance of those same duties.

c. The North Carolina Department of Human Resources when in the performance of its collection duties for intentional program violations and violations due to inadvertent household error under the Food Stamp Program enabled by Chapter 108A, Article 2, Part 5, and any county operating the same Program at the local level, when and only to the extent such a county is in the performance of Food Stamp Program collection functions.

d. The North Carolina Department of Human Resources when, in the performance of its duties under the Aid to Families with Dependent Children Program or the Aid to Families with Dependent Children -- Emergency Assistance Program provided in Part 2 of Article 2 of Chapter 108A or the Work First Cash Assistance Program established pursuant to the federal waivers received by the Department on February 5, 1996, or under the State-County Special Assistance for Adults Program provided in Part 3 of Article 2 of Chapter 108A, it seeks to collect public assistance payments obtained through an intentional false statement, intentional misrepresentation, intentional failure to disclose a material fact, or inadvertent household error.

e. The Office of the North Carolina Attorney General on behalf of any State agency when the debt has been reduced to a judgment.

f. Any other unit of the executive, legislative, or judicial branch of State government, such as a department, a commission, a board, a council, or The University of North Carolina.

~~As used in this Article:~~

~~(1) "Claimant agency" means and includes:~~

~~a. The State Education Assistance Authority as enabled by Article 23 of Chapter 116 of the General Statutes;~~

~~b. The North Carolina Department of Human Resources when in the exercise of its authority to collect health profession student loans made pursuant to G.S. 131-121;~~

~~c. The North Carolina Department of Human Resources when in the performance of its duties under the Medical Assistance Program enabled by Chapter 108A, Article 2, Part 6, and any county operating the same Program at the local level, when and only to the extent such a county is in the performance of Medical Assistance Program collection functions;~~

~~d. The North Carolina Department of Human Resources when in the performance of its duties, under the Child Support Enforcement Program as enabled by Chapter 110, Article 9 and Title IV, Part D of the Social Security Act to obtain indemnification for past paid public assistance or to collect child support arrearages owed to an individual receiving program services and any county operating the program at the local level, when and only to the extent that the county is engaged in the performance of those same duties;~~

~~e. The University of North Carolina, including its constituent institutions as specified by G.S. 116-2(4);~~

~~f. The University of North Carolina Hospitals at Chapel Hill in the conduct of its financial affairs and operations pursuant to G.S. 116-37;~~

~~g. The Board of Governors of the University of North Carolina and the State Board of Education through the College Scholarship Loan Committee when in the performance of its duties of administering the Scholarship Loan Fund for Prospective College Teachers enabled by Chapter 116, Article 5;~~

~~h. The Office of the North Carolina Attorney General on behalf of any State agency when the claim has been reduced to a judgment;~~

~~i. The State Board of Community Colleges through community colleges as enabled by Chapter 115D~~

~~in the conduct of their financial affairs and operations;~~

~~j. State facilities as listed in G.S. 122C-181(a), School for the Deaf at Morganton, North Carolina Sanatorium at McCain, Western Carolina Sanatorium at Black Mountain, Eastern North Carolina Sanatorium at Wilson, and Gravely Sanatorium at Chapel Hill under Chapter 143, Article 7; Governor Morehead School under Chapter 115, Article 40; Central North Carolina School for the Deaf under Chapter 115, Article 41; Wright School for Treatment and Education of Emotionally Disturbed Children under Chapter 122C; and these same institutions by any other names by which they may be known in the future;~~

~~k. The North Carolina Department of Revenue;~~

~~l. The Administrative Office of the Courts;~~

~~m. The Division of Forest Resources of the Department of Environment, Health, and Natural Resources;~~

~~n. The Administrator of the Teachers' and State Employees' Comprehensive Major Medical Plan, established in Article 3 of General Statutes Chapter 135;~~

~~o. The State Board of Education through the Superintendent of Public Instruction when in the performance of his duties of administering the Scholarship Loan Fund for Prospective Teachers enabled by Chapter 115C, Article 32A and the scholarship loan and grant programs enabled by Chapter 115C, Article 24C, Part 1;~~

~~p. The Board of Trustees of the Teachers' and State Employees' Retirement System and the Board of Trustees of the Local Governmental Employees' Retirement System in the performance of their duties pursuant to Chapters 120, 128, 135 and 143 of the General Statutes;~~

~~q. The North Carolina Teaching Fellows Commission in the performance of its duties pursuant to Chapter 115C, Article 24C, Part 2;~~

~~r. The North Carolina Department of Human Resources when in the performance of its~~

~~collection duties for intentional program violations and violations due to inadvertent household error under the Food Stamp Program enabled by Chapter 108A, Article 2, Part 5, and any county operating the same Program at the local level, when and only to the extent such a county is in the performance of Food Stamp Program collection functions.~~

~~The North Carolina Department of Human Resources when, in the performance of its duties under the Aid to Families with Dependent Children Program or the Aid to Families with Dependent Children -- Emergency Assistance Program provided in Part 2 of Article 2 of Chapter 108A or the Work First Cash Assistance Program established pursuant to the federal waivers received by the Department on February 5, 1996, or under the State-County Special Assistance for Adults Program provided in Part 3 of Article 2 of Chapter 108A, it seeks to collect public assistance payments obtained through an intentional false statement, intentional misrepresentation, intentional failure to disclose a material fact, or inadvertent household error;~~

~~s. The Employment Security Commission of North Carolina.~~

~~t. Any State agency in the collection of salary overpayments from former employees.~~

~~u. The State Board of Education through the Superintendent of Public Instruction when in the performance of his duties of administering the program under which the State encourages participation in the National Board for Professional Teaching Standards (NBPTS) Program, enabled by Section 19.28 of Chapter 769 of the 1993 Session Laws.~~

~~(2) "Debtor" means any individual owing money to or having a delinquent account with any claimant agency which obligation has not been adjudicated satisfied by court order, set aside by court order, or discharged in bankruptcy.~~

~~(3) "Debt" means any liquidated sum due and owing any claimant agency which has accrued through contract, subrogation, tort, operation of law, or any other legal theory regardless of whether there is an outstanding judgment for that sum.~~

~~(4) "Department" means the North Carolina Department of Revenue.~~

~~(5) "Refund" means any individual's North Carolina income tax refund.~~

~~(6) "Net proceeds collected" means gross proceeds collected through final setoff against a debtor's refund minus any collection assistance fee charged by the Department.~~

"§ 105A-3. Remedy additional; mandatory State usage; optional local usage; obtaining identifying ~~information.~~ information; registration.

(a) Remedy Additional. -- The collection remedy under this ~~Article~~ Chapter is in addition to and not in substitution for any other remedy available by law.

(b) Mandatory State Usage. -- All ~~claimant~~ State agencies shall submit, for collection under the procedure established by this ~~Article,~~ Chapter, all debts ~~which~~ they are owed, except debts that they are advised by the Attorney General not to submit because the validity of the debt is legitimately in dispute, because an alternative means of collection is pending and believed to be adequate, or because such a collection attempt would result in a loss of federal funds. Except in the case of a State agency described in G.S. 105A-2(9)a. through d., the State Controller may waive this requirement in situations when an agency's submission of the debts would not be practical or would not be effective.

(b1) Optional Local Usage. -- After complying with the notice and hearing requirements of G.S. 105A-5, a local agency may submit for collection under the procedure established in this Chapter all debts it is owed, other than debts the validity of which is in dispute. Local agencies shall submit debts for collection pursuant to this Chapter only through one of the following:

(1) A clearinghouse established pursuant to an interlocal agreement adopted under Article 20 of Chapter 160A of the General Statutes, pursuant to which the clearinghouse will submit debts on behalf of any requesting local agency.

(2) The North Carolina League of Municipalities.

(3) The North Carolina Association of County Commissioners.

(c) Identifying Information. -- All claimant agencies shall whenever possible obtain the full name, social security number, address, and any other identifying information required by ~~rules promulgated by~~ the Department ~~pursuant to G.S. 105A-16~~ from any person for whom the agencies provide any service or transact any business and who the claimant agencies can foresee may become a debtor under this ~~Article.~~ Chapter.

(d) Registration; Reports. -- A ~~claimant~~ State agency must register with the Department and with the State Controller. Every State agency must report annually to the ~~Department~~ State Controller the amount of debts owed to the agency for which the agency did not submit a claim for setoff and the reason for not submitting the claim.

A clearinghouse or organization that submits debts on behalf of a local agency must register by filing written notice with the Department of its intention to effect collection through setoff. If a clearinghouse registers to submit debts pursuant to this subsection, no other clearinghouse may register to submit debts pursuant to this subsection.

"**§ 105A-4. Minimum sum collectible.**

~~A claimant agency shall not be allowed to effect final setoff and collect debts through use of the remedy established under this Article~~ The Department shall not collect a debt pursuant to this Chapter unless both the debt and the refund, if any, are at least fifty dollars ($50.00).

"**§ 105A-5. Local agency notice, hearing, and determination.**

(a) Prerequisite. -- A local agency may not submit a debt to the Department pursuant to G.S. 105A-6 until it has given the notice required by this section and the claim has been finally determined as provided in this section.

(b) Notice. -- A local agency shall send written notice to the debtor that the agency intends to submit the debt for collection by setoff. The notice shall clearly set forth the basis for the agency's claim to the debt, the intention to apply the debtor's tax refund against the debt, the debtor's opportunity to give written notice of intent to contest the validity of the claim within 30 days after the date the notice was mailed, the mailing address to which the application for a hearing must be sent, and the fact that failure to apply for a hearing in writing within the 30-day period is a waiver of the opportunity to contest the claim, causing potential setoff by default. The written

application by the debtor for a hearing becomes effective upon mailing the application postage prepaid and properly addressed.

(c) Hearing. -- A hearing on a contested claim of a local agency shall be held first before the governing body of the local agency or the governing body's designee. No issues may be considered at the hearing that have been previously litigated. If the debtor disagrees with the determination of the governing body or its designee, the debtor may file a petition for a contested case under Article 3 of Chapter 150B of the General Statutes. The petition must be filed within 30 days after the debtor receives a copy of the determination of the governing body or its designee. Notwithstanding the provisions of G.S. 150B-2, a local agency is an agency for purposes of contested cases and appeals under this Chapter.

(d) Determination. -- It shall be determined at the hearing whether the claimed sum asserted as due and owing is correct, and if not, an adjustment to the claim shall be made. The debtor may appeal the determination as provided in G.S. 105A-9.

~~**Collection of sums due claimant agencies through setoff.**~~

~~Subject to the limitations contained in this Article, the Department of Revenue shall upon request render assistance in the collection of any delinquent account or debt owing to any claimant agency. This assistance shall be provided by setting off any refunds due the debtor from the Department by the sum certified by claimant agency as due and owing.~~

"§ 105A-6. Procedure for setoff.

(a) Notice to Department. -- A claimant agency seeking to attempt collection of a debt through setoff shall notify the Department in writing and supply ~~(i)~~ information necessary to identify the debtor whose refund is sought to be set ~~off and (ii)~~ off. The claimant agency may include with the notification the date, if any, that the debt is expected to expire. ~~Notification to the Department and the furnishing of identifying information must occur on or before a date specified by the Department in the first year preceding the calendar year during which the refund would be paid. The notice is effective to initiate setoff against refunds that would be made in calendar years following the year in which the notice was first made until the date specified in the notice that the debt is expected to expire.~~ The agency shall notify the Department in writing when a debt has been paid or is no longer owed the agency.

(b) Setoff by Department. -- The Department, upon receipt of notification, shall determine each year whether the debtor to the claimant agency is entitled to a refund of at least fifty dollars

($50.00) from the Department. Upon determination by the Department that a debtor specified by a claimant agency qualifies for such a refund, the Department shall ~~notify in writing the claimant agency that a refund is pending, specify its sum, and indicate the debtor's address as listed on the tax return.~~

~~(c) Unless stayed by court order, the Department shall, upon certification as provided in this Article,~~ set off the ~~certified~~ debt against the refund to which the debtor would otherwise be ~~entitled.~~ entitled and shall refund any remaining balance to the debtor as if setoff had not occurred. The Department shall mail the debtor written notice that setoff has occurred. Upon effecting setoffs, the Department shall periodically credit claimant agencies with the net proceeds collected on their behalf.

(d) Refund if Setoff Exceeds Debt. -- If the net proceeds credited to a claimant agency exceed the amount of the debtor's debt, the agency shall refund the balance to the debtor. The refund shall bear interest as provided in G.S. 105A-8(b).

(c) State Agency Notice to Debtor. -- A State agency shall credit to a nonreverting trust account all refund setoffs credited to it. Within 10 days after receipt of a refund setoff from the Department, the State agency shall send written notification to the debtor that the refund has been received. The notice shall clearly set forth the basis for the claim to the refund, the intention to apply the refund against the debt to the claimant agency, the debtor's opportunity to give written notice of intent to contest the validity of the claim within 30 days after the date the notice was mailed, the mailing address to which the application for a hearing must be sent, and the fact that failure to apply for a hearing in writing within the 30-day period is a waiver of the opportunity to contest the claim, causing final setoff by default. The written application by the debtor for a hearing becomes effective upon mailing the application postage prepaid and properly addressed.

If a State agency fails to provide timely notice in accordance with the requirements of this subsection, the State agency shall refund to the debtor the entire amount set off plus the collection assistance fee retained by the Department. That portion of the refund reflecting the collection assistance fee must be paid from the State agency's funds. The refund shall bear interest as provided in G.S. 105A-8(b).

~~"§ 105A-7. Notification of intention to set off and right to hearing.~~

~~(a) The claimant agency, upon receipt of notification from the Department that a debtor is entitled to a refund, shall within 10 days send a written notification to the debtor and a copy of same to the Department of its assertion of rights to the refund or any part thereof. Such notification shall inform the debtor of the claimant agency's intention to direct the Department to apply the refund or any portion thereof against the debt certified as due and owing. For the Department to be obligated to continue holding refunds until receipt of certification of the debt, if any, pursuant to G.S. 105A-10, the copy of the notification to the debtor by the claimant agency of its intention to set off must be received by the Department within 15 days of the date of the Department's mailing to the respective claimant agency the notification of the debtor's entitlement to a refund.~~

~~(b) The contents of the written notification to the debtor (and the Department's copy) of the setoff claim shall clearly set forth the basis for the claim to the refund, the intention to apply the refund against the debt to the claimant agency, the debtor's opportunity to give written notice of intent to contest the validity of the claim within 30 days of the date of the mailing of the notice, the mailing address to which the application for a hearing must be sent, and the fact that failure to apply for a hearing in writing within the 30-day period will be deemed a waiver of the opportunity to contest the claim causing final setoff by default.~~

~~(c) The written application by the debtor for a hearing shall be effective upon mailing the application postage prepaid and properly addressed to the claimant agency.~~

"**§ 105A-8. ~~Hearing procedure.~~ State agency hearing and determination.**

(a) Hearing. -- A hearing on a contested ~~claim,~~ claim of a State agency, other than a claim of a constituent institution of The University of North Carolina, or a claim of the Employment Security Commission of North Carolina, shall be conducted in accordance with Article 3 of Chapter 150B of the General Statutes. A hearing on a contested claim of a constituent institution of The University of North Carolina shall be conducted in accordance with administrative procedures approved by the Attorney General. A hearing on a contested claim of the Employment Security Commission of North Carolina shall be conducted in accordance with regulations adopted by the Employment Security Commission of North Carolina. No issues may be considered at the hearing that have been previously litigated.

(b) Determination; Refund. -- ~~Additionally, it~~ It shall be determined at the hearing whether the claimed sum asserted as due and owing is correct, and if not, an adjustment to the claim shall be made. If it is determined that the amount set off is excessive, the State agency shall refund the excess amount to the taxpayer. If it is determined that the State agency is not entitled to any part of the amount set off, the State agency shall refund the entire amount set off plus the collection assistance fee retained by the Department. That portion of the refund reflecting the collection assistance fee must be paid from the State agency's funds. If a refund is made to the taxpayer, the State agency shall pay interest to the taxpayer calculated as provided in G.S. 105-241.1(i) from the date one day after the date through which the Department pays interest on the refund or the date that interest begins to accrue, as provided in G.S. 105-266(b), whichever is later.

~~(b) Pending final determination at hearing of the validity of the debt asserted by the claimant agency, no action shall be taken in furtherance of collection through the setoff procedure allowed under this Article.~~

~~(c) No issues may be considered at the hearing which have been previously litigated.~~

"§ 105A-9. Appeals from hearings.

Appeals from action taken at hearings allowed under this ~~Article~~ Chapter shall be in accordance with the provisions of Chapter 150B of the General Statutes, the Administrative Procedure Act, except that the place of initial judicial review shall be the superior court for the county in which the debtor resides. Appeals from actions allowed under this ~~Article~~ Chapter conducted by the Employment Security Commission of North Carolina shall be in accordance with the provisions of Chapter 96 of the General Statutes.

~~"§ 105A-10. Certification of debt by claimant agency; finalization of setoff.~~

~~(a) Upon final determination through hearing provided by G.S. 105A-8 of the debt due and owing the claimant agency or upon the debtor's default for failure to comply with G.S. 105A-7 mandating timely request for review of the asserted basis for setoff, the claimant agency shall within 20 days certify the debt to the Department and in default thereof, the Department shall no longer be obligated to hold the refund for setoff.~~

~~(b) Upon receipt by the Department of a certified debt from the claimant agency, the Department shall finalize the setoff by transferring the net proceeds collected for credit or payment in~~

~~accordance with the provisions of G.S. 105A-14 and by refunding any remaining balance to the debtor as if setoff had not occurred.~~

~~"§ 105A-11. Notice of final setoff.~~

~~Upon the finalization of setoff under the provisions of this Article, the Department shall notify the debtor in writing of the action taken along with an accounting of the action taken on any refund. If there is an outstanding balance after setoff, the notice under this section shall accompany the balance when disbursed.~~

"§ 105A-12. Priorities in claims to setoff.

~~Priority in multiple claims to refunds allowed to be set off under the provisions of this Article shall be in the order in time which a claimant agency has filed a written notice with the Department of its intention to effect collection through setoff under this Article. Notwithstanding the priority set forth above according to time of filing, the~~ The Department has priority over all other claimant agencies for collection by setoff whenever it is a competing agency for a refund. State agencies have priority over local agencies for collection by setoff. When there are multiple claims by State agencies other than the Department, the priority shall be in the order in time in which each agency registered for setoff pursuant to G.S. 105A-3. When there are multiple claims by organizations submitting debts on behalf of local agencies, the priority shall be in the order in time in which each organization registered for setoff pursuant to G.S. 105A-3. When there are multiple claims among local agencies whose debts are submitted by a single organization, the priority shall be in the order in time in which each local agency requested the organization to submit debts on its behalf.

"§ 105A-13. ~~Disposition of proceeds collected; collection~~ Collection assistance fees.

~~(a) Upon effecting final setoffs, the Department shall periodically write checks to the respective claimant agencies for the net proceeds collected on their behalf.~~

~~(b) Each year the Department shall determine its actual cost of collection under the Setoff Debt Collection Act for the immediately preceding year and shall calculate the percentage that cost represents of the preceding year's collections, excluding collections of child support arrearages under G.S. 105A-2(1)d.~~ To recover its cost of collection under this Chapter, the ~~The~~ Department shall ~~retain that percentage from the gross proceeds collected by the Department through setoff for the current year, other than the gross proceeds collected of child~~

~~support arrearages under G.S. 105A-2(1)d.~~ add a collection assistance fee to each debt collected through setoff, collect it as part of the debt, and retain it. The collection assistance fee shall be determined based on the Department's actual cost of collection under this Chapter for the immediately preceding year and shall not exceed fifteen dollars ($15.00). If the Department is able to collect only part of a debt through setoff, the collection assistance fee has priority over the remainder of the debt. The collection assistance fee shall not be added to child support debts or collected as part of child support debts. The Department shall retain from collections under Division II of Article 4 of Chapter 105 of the General Statutes the cost of collection of child support debts under this Chapter.

"§ 105A-14. Accounting to the claimant agency; credit to debtor's obligation.

(a) Simultaneously with the transmittal of ~~a check for~~ the net proceeds collected to a claimant agency, the Department shall provide the agency with an accounting of the setoffs ~~finalized~~ for which payment is being made. The accounting shall, whenever possible, include the full names of the debtors, the debtors' social security numbers, the gross proceeds collected per ~~individual~~ setoff, the net proceeds collected per setoff, and the collection assistance fee added to the debt and collected ~~charged~~ per setoff.

(b) Upon receipt by a claimant agency of ~~a check representing~~ net proceeds collected on ~~a~~ the claimant agency's behalf by the ~~Department~~ Department, a final determination of the claim, and an accounting of the proceeds as specified under this section, the claimant agency shall credit the debtor's obligation with the ~~gross~~ net proceeds collected.

"§ 105A-15. Confidentiality exemption; nondisclosure.

(a) Notwithstanding G.S. 105-259 or any other provision of law prohibiting disclosure by the Department of the contents of taxpayer records or information and notwithstanding any confidentiality statute of any claimant agency, ~~all~~ the exchange of any information ~~exchanged~~ among the Department, the claimant agency, the organization submitting debts on behalf of a local agency, and the debtor necessary to ~~accomplish and effectuate the intent of this Article~~ implement this Chapter is lawful.

(b) The information ~~obtained by~~ a claimant agency or an organization submitting debts on behalf of a local agency obtains from the Department in accordance with the exemption allowed by subsection (a) ~~shall only~~ may be used by ~~a claimant~~ the agency or organization only in the pursuit of its debt collection duties

and ~~practices and any person employed by, or formerly employed by, a claimant agency who discloses any such information for any other purpose, except as otherwise allowed by G.S. 105-259, shall be penalized in accordance with the terms of that statute.~~ practices and may not be disclosed except as provided in G.S. 105-259, 153A-148.1, or 160A-208.1.

"**§ 105A-16. ~~Rules and regulations.~~ Rules.**

The Secretary of Revenue ~~is authorized to prescribe forms and make all rules which he deems necessary in order to effectuate the intent of this Article.~~ may adopt rules to implement this Chapter."

Sec. 2. G.S. 105-266(b) reads as rewritten:

"(b) Interest. -- An overpayment of tax bears interest at the rate established in G.S. 105-241.1(i) from the date that interest begins to accrue until a refund is paid. A refund is considered paid on a date determined by the Secretary that is no sooner than five days after a refund check is ~~mailed.~~ mailed or, in the case of a refund set off against a debt pursuant to Chapter 105A of the General Statutes, five days after the Secretary's notice of setoff is mailed.

Interest on an overpayment of a tax, other than a tax levied under Article 4 or Article 8B of this Chapter, accrues from a date 90 days after the date the tax was originally paid by the taxpayer until the refund is paid. Interest on an overpayment of a tax levied under Article 4 or Article 8B of this Chapter accrues from a date 45 days after the latest of the following dates until the refund is paid:

(1) The date the final return was filed.

(2) The date the final return was due to be filed.

(3) The date of the overpayment.

The date of an overpayment of a tax levied under Article 4 or Article 8B of this Chapter is determined in accordance with section 6611(d), (f), (g), and (h) of the Code."

Sec. 3. The changes to G.S. 105A-3(d), 105A-5, and 105A-16 made by this act are effective when this act becomes law. The remainder of this act becomes effective January 1, 1998.

Explanation - Modify Setoff Debt Collection
Legislative Proposal 5

This proposal would modify the Setoff Debt Collection Act, Chapter 105A of the General Statutes, under which the Department of Revenue retains the income tax refund of an individual who owes money to a State agency and then sends the refund to the State agency to be applied to the debt. The proposal would make the following changes effective January 1, 1998:

1. It would authorize local agencies to submit debts owed them for collection by setoff against individuals' North Carolina tax refunds. Local agencies would be required to provide the debtor notice and an opportunity to contest the debt before the debt is submitted for setoff.
2. It would provide that in the case of debts owed to State agencies, the agency, rather than the Department of Revenue, will hold the setoff amounts while the debtor is given notice and an opportunity to contest the debt.
3. It would require those State agencies not currently allowed to use the program to submit debts owed them for collection by setoff.
4. It would provide that the Department of Revenue's costs in collecting debts by setoff, which are recovered through collection assistance fees, will be charged to the debtor rather than the State agency owed the debt. Child support collection assistance fees, which are now paid for by the various State agencies, will be drawn from the General Fund.
5. It would cap the collection assistance fee at $15.00 per debt collected.
6. It would modernize, clarify, simplify, and reorganize the language of the Setoff Debt Collection Act.

This proposal originated as Senate Bill 761, introduced in 1995 by Senator Conder to add local governments to the setoff program. The Department of Revenue determined that the bill would cause significant administrative problems, and asked that the bill be redesigned to address those problems. After many meetings, and in consultation with affected State agencies as well as the State Controller, this proposal was developed to provide local governments access to the setoff debt collection program and to simplify the administration of the program.

Local governments would be authorized to submit their debts for collection by setoff only after providing the debtor with notice, an opportunity to be heard before the local government, and an appeal process pursuant to the Administrative Procedure Act. After completing this process, the agency can submit the debt through the League of Municipalities, the Association of County Commissioners, or another clearinghouse. Funneling the debts through a clearinghouse rather than having each local government submit its own debts will avoid placing an undue administrative burden on the Department of Revenue.

Under current law, if the Department of Revenue finds that a debtor is entitled to a tax refund, the Department notifies the State agency to whom the debt is owed and holds the

refund until the State agency notifies the debtor and gives the debtor an opportunity for a hearing and an appeal. This proposal would reduce the administrative burden on the Department of Revenue by authorizing the Department to pay the setoff refund to the State agency at once. The agency would hold the refund while providing the notice, hearing, and appeal to the debtor. The Department of Revenue would also notify the debtor of the potential setoff. A debtor would have the same procedural and substantive rights as under current law, including the right to interest on any part of the refund found not to be a valid debt. If the State agency failed to provide the debtor timely notice, the State agency would be required to refund to the debtor the entire amount set off.

The Setoff Debt Collection Act currently requires certain named State agencies to participate. Other State agencies may not participate, even on a volunteer basis. This proposal would extent the mandatory State program to all State agencies, as recommended by the State Controller's Office, which administers the Statewide accounts receivable program pursuant to G.S. 147-86.22. If a State agency's use of the program would not be practical or effective in certain cases, the State Controller could waive the requirement.

The cost of administering the setoff debt collection program is paid by the State agencies whose debts are collected by setoff. Each year, the Department of Revenue determines its costs of running the program and recovers these costs by charging a collection assistance fee as a percentage of each debt collected. This proposal would cap this fee at no more than $15.00 per debt. The actual fee is expected to be less.

This proposal would shift the burden of paying the administrative costs of most setoffs from participating State agencies to the debtors. Except in the case of child support arrearages, discussed below, the Department of Revenue retains the collection assistance fee from each setoff. The fee is credited to the debtor but is absorbed by the agency to whom the debt is owed. Under this proposal, the collection assistance fee will still be retained from each setoff but will not be credited toward the debt the debtor owes. As a result, the debtor will pay the fee out of the tax refund that was set off. This change will shift approximately $270,000, the cost of collecting about 39,000 debts, from State agencies' budgets to debtors.

Under current law, the Department of Human Resources and certain county agencies are defined as State agencies that use the debt setoff program to collect child support arrearages pursuant to the federal Child Support Enforcement Program. Since January 1, 1996, rather than deducting its administrative costs from amounts collected for child support arrearages, the Department of Revenue has been required to spread among other State agencies the portion of the Department's administrative costs attributable to child support collections. That change shifted child support setoff administrative costs from child support collections to other setoff collections, resulting in an increase in the percentage deducted from those other collections. This proposal would provide that the administrative costs of collecting child support arrearages would be drawn from the General Fund rather than deducted from the amounts collected on behalf of State agencies. The General Fund bears the cost in either case, but under the proposal the cost will not come from amounts appropriated to State agencies for other purposes.

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: PROPOSAL #5

SHORT TITLE: MODIFY SETOFF DEBT COLLECTION

FUNDS AFFECTED: General Fund (X) Highway Fund ( ) Local Funds (X)
Other Fund ( ) Departmental Receipts (X)

BILL SUMMARY: The 1979 General Assembly approved legislation to allow selected State agencies to request the Department of Revenue to offset income tax refunds (if refund at least $50) as a means of collecting debts owed agencies by taxpayers. The Department of Revenue's cost of collecting the debt is earmarked from refunds offset, with the earmarking based on the prior year's experience.

The program has been modified over the years as other agencies have asked to be included. The proposal modifies the program as follows:

(1) Authorizes local agencies to submit debts for setoff
(2) Provides that the agency, rather than the Department of Revenue, hold the setoff amount while the debtor is given notice and an opportunity to contest the debt.
(3) Requires State agencies not currently allowed to use the program to submit debts for setoff.
(4) Provides that the Department of Revenue's costs of administering the program be charged to the debtor instead of the state agency. In addition, Child Support collection fees now paid for by the earmarking of debt setoff proceeds of all participating agencies be funded directly from an earmarking of General Fund tax revenue.
(5) Limits collection assistance fee to $15 per debt collected.

FISCAL IMPACT:

(1) Authorizing local government units to participate in the program will increase revenue for the cities and counties that participate. There is no data available at this time to calculate the gains. However, if the change allowed local units to collect 1/3 of their delinquent property tax bills, the additional receipts would be over $37 million.

This provision will substantially increase the number of claims processed by the Department of Revenue. However, the proposal to shift more of the administrative burden to claimant agencies and the use of a clearinghouse to submit claims for local units should help offset the additional workload. In addition, the new claims will be eligible for collection assistance fees.

(2) Requiring State agencies currently not eligible for the program to participate will increase agency receipts by a maximum of $1 million per year. In theory, the additional receipts should reduce General Fund budget requirements for the recipient agencies. At this time it is estimated that as much as 90% of the potential claim volume in State government is covered by the program.

(3) Requiring the Department of Revenue's costs to be paid by the debtor instead of being earmarked out of the refunds offset would increase agency receipts by a maximum of $270,000 per year at the current claims volume. This adjustment should reduce General Fund budget requirements. In cases where the tax refund is greater than the debt, more of the taxpayer's refund will be offset. If the debt is greater than the refund, the collection cost will be added to the debt amount to be carried over to the following year.

(4) The shift in the funding of child support collection costs to a General Fund earmarking from an earmarking of refunds offset will change how the General Fund pays for the costs, but there will be no change in overall budget requirements.

POSITIONS: The Department of Revenue has indicated that if the provision shifting much of the administrative responsibility to the claimant agencies is approved, there might not be a need for additional personnel to deal with the other changes.

DATA, ASSUMPTIONS AND METHODOLOGY: The Department of Revenue has provided data claims experience for the last 5 calendar years. In addition, discussions with the Office of State Controller and the Department of Revenue helped address some of the fiscal issues.

FISCAL RESEARCH DIVISION
733-4910
PREPARED BY: DAVE CROTTS
APPROVED BY:
DATE: DECEMBER 27, 1996
[FRD#003]

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S/H **D**

Legislative Proposal 6
97-LC-014(1.1)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Interstate Auditors/Regulatory Fund. (Public)

Sponsors: Senators Kerr, Cochrane, Cooper, Shaw, and Soles. Representatives Neely, Blue, Cansler, Capps, Church, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ENHANCE COMPLIANCE AND ENFORCEMENT OF EXISTING TAX LAWS BY APPROPRIATING FUNDS TO EXPAND THE NUMBER OF AUDITORS AND SUPPORT PERSONNEL IN THE INTERSTATE AUDIT DIVISION OF THE DEPARTMENT OF REVENUE, AND TO PROVIDE THAT PERSONNEL WHO ADMINISTER THE INSURANCE GROSS PREMIUMS TAX SHALL CONTINUE TO BE FUNDED FROM THE INSURANCE REGULATORY CHARGE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 58-6-25(d) reads as rewritten:

"(d) Use of Proceeds. -- The Insurance Regulatory Fund is created in the State treasury, under the control of the Office of State Budget and Management. The proceeds of the charge levied in this section and all fees collected under Articles 69 through 71 of this Chapter and under Articles 9 and 9C of Chapter 143 of the General Statutes shall be credited to the Fund. The Fund shall be placed in an interest-bearing account and any interest or other income derived from the Fund shall be credited to the Fund. Moneys in the Fund may be spent only pursuant to appropriation by the General Assembly and in accordance with the line item budget enacted by the General Assembly. The Fund is subject to the provisions of the Executive Budget Act, except that no unexpended surplus of the Fund shall revert to the General Fund. All money

credited to the Fund shall be used to reimburse the General Fund for the following:

(1) Money appropriated to the Department of Insurance to pay its expenses incurred in regulating the insurance industry and other industries in this State.

(2) Money appropriated to State agencies to pay the expenses incurred in regulating the insurance industry, in certifying statewide data processors under Article 11A of Chapter 131E of the General Statutes, and in purchasing reports of patient data from statewide data processors certified under that Article.

(3) Money appropriated to the Department of Revenue to pay the expenses incurred in collecting and administering the taxes on insurance companies levied in Article 8B of Chapter 105 of the General Statutes."

Section 2. The two positions transferred from the Department of Insurance to the Department of Revenue for the 1995-96 fiscal year to collect the taxes on insurance companies levied in Article 8B of Chapter 105 of the General Statutes shall be funded from the Insurance Regulatory Fund established in G.S. 58-6-25, as they were before their transfer. The portion of the Department of Revenue's budget formerly dedicated to supporting these two positions, ninety-nine thousand two hundred seventy dollars ($99,270), shall be used to support additional positions in the Interstate Audit Division.

Section 3. There is appropriated from the General Fund to the Department of Revenue the sum of three hundred four thousand seven hundred twenty-seven dollars ($304,727) for the 1997-98 fiscal year and the sum of six hundred thirteen thousand seven hundred thirty-two dollars ($613,732) for the 1998-99 fiscal year for seven additional auditors in the Interstate Audit Division, two tax technicians as support personnel in the Interstate Audit Division, and a tax administrator III in the Tax Administration Division, and for other costs resulting from the additional tax enforcement personnel.

Section 4. This act becomes effective July 1, 1997.

Explanation - Interstate Auditors/Regulatory Fund
Legislative Proposal 6

This proposal makes the following changes effective July 1, 1997:

(1) Provides that Department of Revenue personnel who collect the insurance gross premiums tax can be funded from the Insurance Regulatory Fund.

(2) Provides that the two positions transferred from the Department of Insurance to the Department of Revenue for the 1995-96 fiscal year to collect the premiums tax will be funded from the Insurance Regulatory Fund. The position transferred from Insurance to Revenue in 1996 is already supported from the Fund.

(3) Provides that the Department's funds currently supporting the two positions shall be used to support additional staff in the Interstate Audit Division. The amount of funds supporting the two positions is $99,270.

(4) Appropriates additional funds to support the following new personnel for the Department of Revenue:
   - Seven auditors in the Interstate Audit Division
   - Two tax technicians as support personnel to the auditors
   - One tax administrator III in the Tax Administration Division

By increasing the number of auditors in the Interstate Audit Division, the State can increase its General Fund tax collections without raising taxes. Although there is a point of diminishing returns in adding new auditors, that point has not been reached in North Carolina. As additional audits are performed, revenues will increase due to improved compliance with and enforcement of existing laws. The 1996 Revenue Laws Study Committee recommended the hiring of fifteen auditors and two support personnel. Eight auditors, one tax technician, and one clerical position were added during the 1996 Session. In 1996, the General Assembly also directed the State Budget Office's Management and Productivity Unit to work with the Department of Revenue to assess the Department's staff requirements and report to the House and Senate Appropriations Subcommittees on General Government by March 1, 1997.

The 1995 General Assembly transferred from the Department of Insurance to the Department of Revenue the responsibility for collecting gross premiums taxes. The transfer was completed in two stages, the first effective January 1, 1996, and the second a year later. Two positions were transferred from Insurance to Revenue for the first stage and a third position was transferred for the second stage. The transfer of the third position included explicit instructions that the position would continue to be funded from the insurance regulatory charge. The two positions transferred earlier did not retain their funding support from the insurance regulatory charge, however. This proposal restores the insurance regulatory charge as the source of funding for the first two positions transferred from Insurance to Revenue. This funding change will free up $99,270 in the Department of Revenue's budget, to help offset the cost of the new auditors for the Interstate Audit Division.

The insurance gross premiums taxes are annual taxes based on the amount of insurance premiums that are paid or, for certain self-insurers, would have been paid during the year. They consist of a 1.9% premiums tax on for-profit insurance companies, a 0.5% tax on nonprofit companies, such as Blue Cross/Blue Shield and Delta Dental, that provide hospital, medical, and dental coverage, a 2.5% tax on workers' compensation premiums and workers' compensation self-insurers, a 1.33% additional fire and lightning tax on property insurance premiums for coverage of property other than motor vehicles and boats, and another 0.5% fire and lightning tax on all property insurance premiums on property inside a municipality. The insurance regulatory charge, which is a percentage of gross premiums tax liability, was imposed on insurance companies in 1991 in order to make the Department of Insurance receipt-supported and thereby eliminate General Fund support of that department.

Proposal #6: Additional Interstate Auditors/Pay Premiums Tax Positions from Insurance Regulatory Charge

Explanation:

Proposed legislation appropriates funds to expand the number of auditors and support personnel in the Interstate Audit Division and in divisions with collateral workloads that will experience an increase. Additionally, provides that funding from the insurance regulatory fee support the two (2) positions transferred per 1995 Session Law from the Department of Insurance to the Department of Revenue with the transfer of responsibility for collecting the gross premiums tax.

Effective Date:

January 1, 1998 for the additional Interstate Audit Division personnel; and July 1, 1997 for transfer of funds from the insurance regulatory charge.

Fiscal Effect:

For the additional audit personnel the first year estimate supports recurring costs of salaries, benefits, and supplies; and non-recurring costs for computer equipment and office furnishings. The annual estimates of continued costs include a 4% increase in salaries, only. The receipt from the insurance regulatory charge reflects annual expense of the two (2) positions.

Interstate Audit Division

The recommendations from the Revenue Laws Study Committee and the Governor's recommended budget changes for FY 1996-97 to the 1996 Session of the General Assembly included $1 million to add 15 auditors, 2 Tax Technicians, 2 Processing Assistant positions, and an Administrative Officer with employment phased-in over a three month period - October 1, November 1, and December 1. The General Assembly appropriated $323,289 for 10 positions - 8 auditors, 1 Tax Technician, and 1 Processing Assistant effective January 1, 1997.

The proposed legislation adds the balance of the positions initially requested in 1996 Session. There are currently 22 auditors assigned to the division with the anticipation of 30 positions available January 1, 1997. Of the 30 auditors, sixteen (16) will be located in Raleigh and fourteen (14) in satellite offices operating in eight (8) states. According to the division, assessments continue to average $2 million annually per auditor with current average expenses per auditor of $64,000. Following a year or two of assessments by the new auditors, the average annual assessment and average expenses per auditor may change.

For the proposed increase in staff, all positions in the first year of service (FY 97-98), would begin employment January 1, 1998. The division anticipates that each new auditor will gross $1 million in assessments (or one-half of the average annual assessment) in the first year. An estimated 75% of all audit assessments are collected, which provides a yield in collections of $5.25 million. The expectation is that 7 new Interstate Auditors will produce approximately $14 million annually in additional assessments, thus the 7 new audit positions should contribute approximately $10.5 million in new tax revenue annually in subsequent years.

The three (3) remaining positions will be assigned throughout the department. The two (2) Tax Technician positions will assist in supporting new and existing auditing staff to allow concentration more on conducting audits, and less time on research, refund claims and other administrative responsibilities. As a result of the added assessments, workloads in collateral divisions will also increase. The Administrative Officer will be assigned to the Corporate Tax Division to allow improved responses to Corporate tax inquiries, and offset the increased workload resulting from the new audit positions.

******An additional consideration related to increasing personnel in the Department of Revenue is the result of the assessment of staff requirements authorized by the General Assembly in the 1996 Second Extra Session (Chapter 18, Section 15.6). The State Budget Office, Management and Productivity Unit is conducting the assessment with a joint report from the State Budget Officer and the Secretary of Revenue due March 1, 1997 to the House and Senate Appropriations Subcommittees on General Government.******

Premiums Tax Positions

In the 1995 Session the General Assembly transferred responsibility for collecting the gross premiums tax from the Department of Insurance to the Department of Revenue, effective January 1, 1996. Two (2) positions were transferred from Insurance to Revenue with funding provided by the insurance regulatory charge. However, there was no provision for the insurance regulatory charge to continue funding the costs associated with the positions' responsibilities beyond the second half of FY 1995-96. With the transfer of a third position on January 1, 1997 the General Assembly included language in the authorizing legislation to provide continued support from the regulatory charge. Because the intention of the General Assembly is to fund the three (3) positions from the regulatory charge, the proposed legislation, again, assigns funding from this source. If authorized, $99, 270 would transfer from the Department of Insurance to the Department of Revenue, and thereby reduce General Fund requirements in the Department of Revenue's budget.

Proposal #6 (continued)
December 30, 1996

	FY 97-98	FY 98-99	FY 99-00	FY 00-01	FY 01-02
REVENUES					
GENERAL FUND:	5,349,270	10,599,270	10,599,270	10,599,270	10,599,270
HIGHWAY FUND					
HIGHWAY TRUST FUND					
LOCAL					
EXPENDITURES					
Recurring	209,227	613,732	634,982	657,071	680,101
Non-Recurring	102,500				
POSITIONS:	10	10	10	10	10

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S **D**

Legislative Proposal 7
97-LC-009(1.1)
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Sale of Property for Unpaid Taxes. (Public)

Sponsors: Senators Cooper, Cochrane, Kerr, Shaw, and Soles.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ALLOW REGIONAL SALES OF PERSONAL PROPERTY SEIZED FOR UNPAID TAXES TO BE HELD IN ANY COUNTY.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-242(a) reads as rewritten:

"(a) Warrants for Collection of Taxes. -- If any tax levied by the State and payable to the Secretary has not been paid within 30 days after the taxpayer was given a notice of final assessment of the tax under G.S. 105-241.1(d1), the Secretary may take either of the following actions to collect the tax:

(1) The Secretary may issue a warrant or an order under the Secretary's hand and official seal, directed to the sheriff of any county of the State, commanding him to levy upon and sell the real and personal property of the taxpayer found within the county for the payment of the tax, including penalties and interest, and the cost of executing the warrant and to return to the Secretary the money collected, within a time to be specified in the warrant, not less than 60 days from the date of the warrant; the sheriff upon receipt of the warrant shall proceed in all respects with like effect and in the same manner prescribed by law in respect to executions

issued against property upon judgments of a court of record, and shall be entitled to the same fees for ~~his~~ services in executing the warrant, to be collected in the same manner.

(2) The Secretary may issue a warrant or order under the Secretary's hand and seal to any revenue officer or other employee of the Department of Revenue charged with the duty to collect taxes, commanding the officer or employee to levy upon and sell the taxpayer's personal property, including that described in G.S. 105-366(d), found within the State for the payment of the tax, including penalties and interest. Except as otherwise provided in this subdivision, the levy upon the sale of personal property shall be governed by the laws regulating levy and sale under execution. The person to whom the warrant is directed shall proceed to levy upon and sell the personal property subject to levy in the same manner and with the same powers and authority normally exercised by sheriffs in levying upon and selling personal property under execution, except that the property may be sold in ~~Wake County or in the county in which it was seized,~~ any county, in the discretion of the Secretary. In addition to the notice of sale required by the laws governing sale of property levied upon under execution, the Secretary may advertise the sale in any reasonable manner and for any reasonable period of time to produce an adequate bid for the property. Levy and sale fees, plus actual advertising costs, shall be added to and collected in the same manner as taxes."

Sec. 2. This act becomes effective July 1, 1997.

Explanation - Sale of Property for Unpaid Taxes

Under current law, the Department of Revenue may seize personal property in order to collect delinquent unpaid taxes and may sell the property either in Wake County or in the county in which it was seized. This proposal would allow the property to be sold in any county, effective July 1, 1997. The proposal will operate to allow the property to be sold closer to the debtor's home county and will save the State money because under current law, the only practical option is to sell the property in Wake County.

G.S. 105-242 authorizes the Secretary of Revenue to levy on a taxpayer's personal property to collect delinquent taxes. This statute is used almost exclusively by the Controlled Substance Tax Division, which collects the tax on illegal drugs. Vehicles and other property are often seized for these taxes pursuant to G.S. 105-113.111. G.S. 105-113.113 provides that 75% of the tax proceeds assessed and collected are distributed among the law enforcement agencies whose investigation led to the assessment.

Because it is impractical to store and sell seized property in all 100 counties, the Department sells all of the property in Wake County. It contracts to have the property hauled from all over the State and then stored until an auction site is available. Rental of auction sites in Wake County is expensive and, because of delays due to overbooking of the sites, the Department incurs extra costs for storing the property.

Expanding the permissible locations for sales will allow the Department to auction property in the Eastern, Western, and Central regions of the State. Expenses will be reduced because the property will not have to be hauled as far and there will be less storage time waiting for an auction site to become available. More companies will be able to compete for the transportation, storage, and sale business because they will no longer have to have Statewide operations in order to qualify. Opening the bidding process could yield a lower contract price.

This proposal was requested by the Department of Revenue. The Department of Revenue estimates that it could reduce expenses by as much as $100,000 a year.

Fiscal Report
Fiscal Research Division
December 31, 1996

Proposal 7: Allow Sale of Personal Property in Any County

Summary: This act authorizes the Department of Revenue to sale in any county the personal property seized for non payment of taxes.

Effective Date: July 1, 1997.

Fiscal Effect:

The Director of the Department of Revenue's Controlled Substance Tax Division estimates this bill will save a minimum of $39,000 each year. This savings is apportioned in the same ratio as the proceeds from seized property - 75% to state and local law enforcement agencies and 25% to the General Fund.

The savings comes from the storage of seized vehicles and from the rental of space in Wake county for the vehicle sales. The Department contracts to have the vehicles hauled from all over the State and then stored until an auction site is available. The vehicles seized for the nonpayment of the controlled substance tax are stored in Wayne County and brought to Wake County for sale. Rental of auction sites in Wake County is expensive and, because of delays due to overbooking of the sites, the Department incurs extra costs for storing the property.

With passage of the bill, the Department will save $12,000 by not renting auction sites in Raleigh four times a year. Expanding the permissible locations for sales will allow the Department to auction property in each region of the State at sites provided by a contractor. The Department estimates storage cost will be reduced by $27,000 because there will be less time waiting for an auction site to become available. This estimate is based on storage of 300 cars for 30 days at $3 a day.

The Department believes opening the bidding process will yield a lower contract price for handling seized property and thus produce greater savings in the program. More companies will be able to compete for the transportation, storage, and sale business because they will no longer have to have Statewide operations in order to qualify.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 8
97-RBZ-026A
THIS IS A DRAFT 14-JAN-97 16:31:39

Short Title: Make Use Tax User-Friendly. (Public)

Sponsors: Representatives Capps, Blue, Cansler, Church, Neely, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO RELIEVE CONSUMERS OF THE REQUIREMENT OF FILING MONTHLY USE TAX RETURNS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.16 is amended by adding a new subsection to read:

"(d) Use Tax on Out-of-State Purchases. -- Notwithstanding subsection (b), an individual who purchases tangible personal property outside the State for a non-business purpose shall file a use tax return on an annual basis. The annual reporting period ends on the last day of the calendar year. The return is due by the due date, including any approved extensions, for filing the individual's income tax return."

Sec. 2. This act is effective when it becomes law and applies to purchases made on or after January 1, 1997.

EXPLANATION: MAKE USE TAX USER FRIENDLY

Under current State law, a person is responsible for paying the use taxes on their out-of-state purchases, whether they are collected by the catalog company or paid directly to the State. By law, North Carolina customers of mail-order catalog companies should be filing a return and remitting the tax due quarterly if the tax owed is less than $50.00. If the amount owed the previous month is greater than $50.00, then the person should be remitting the tax due monthly. This proposal seeks to improve the enforcement of the tax by minimizing the compliance burden.

Under this proposal, individuals who owe use tax on goods purchased out-of-state for a non-business purpose will be able to file an annual use tax return. The return and the tax would be due at the same time as the personal income tax return. In theory, residents who are subject to use tax for out-of-state purchases are more likely to comply if the reporting and payment procedure is not unduly burdensome.

In an effort to make consumers more aware of this responsibility, the Department began including a use tax return with the individual income tax return in 1991. However, since the reporting period remains monthly or quarterly, dependent upon the amount of use tax owed, many taxpayers find themselves subject to interest and penalties for late filing. Not only is the reporting period a deterrent to filing, it is also a source of taxpayer irritation. This proposal, recommended by the Department, seeks to make it easier, and less troubling, for individuals to comply with the use tax law.

The use tax complements the sales tax by taxing transactions which are not subject to the sales tax because of movement in interstate commerce. Like the sales tax, the use tax is imposed on the purchaser. Unlike the sales tax, the responsibility for remitting the tax to the Department is also on the purchaser. In the 1980s, states around the country became increasing aware of the revenue loss from taxpayer avoidance of the use tax. The Department estimated in 1995 that the potential increase in State and local revenue for North Carolina, if full taxpayer compliance was achieved, was $71.1 million.

The most cost-effective manner to collect the tax, from a state's point-of-view, is to require the out-of-state retailers to collect and remit the use tax. However, in 1967, the U.S. Supreme Court ruled in Bellas Hess that a state can not require an out-of-state retailer to collect its use tax unless the retailer has enough contacts with the state to subject it to the state's taxing jurisdiction. The

Supreme Court reaffirmed this decision in 1992 in Quill Company v. North Dakota.

In an effort to collect a larger percentage of this tax, North Carolina has entered a cooperative agreement with other southeastern states called the Southeastern States Exchange Agreement. The member states to this agreement exchange information gained through tax audits of businesses, such as the names and addresses of North Carolina customers to whom untaxed sales were made. The Department may then contact these customers for the collection of the use tax, plus penalties and interest.

Fiscal Report
Fiscal Research Division
December 30, 1996

Proposal 8: Annual Use Tax Filing by Consumers

Summary: The proposed bill relieves consumers from filing monthly use tax returns.

Effective Date: The act is effective upon ratification and applies to purchases made on or after January 1, 1997.

Fiscal Effect:

NO FISCAL IMPACT

Without increased enforcement efforts by the Department of Revenue, this change will not increase compliance with the law. It will bring into compliance those taxpayers who take the time to fill out Form E-554 when they do their annual income tax returns. For the Department to begin collecting from individuals the estimated $47.4 million in state use tax and $23.7 million in local use tax that is due on catalog purchases, it would take a tremendous increase in auditing manpower and other support personnel. Instead, the best way to collect this tax liability is through the cooperation of mail order companies. In 1996, the General Assembly granted the Secretary of Revenue the authority to "enter into agreements with sellers pursuant to which the seller agrees to collect and remit on behalf of its customers State and local use taxes due on items of tangible personal property the seller sells." (SB6, Chapter 14, 1996 Second Extra Session) It is hoped that an use tax collection agreement will be hammered out between the Direct Marketers Association, the Federation of Tax Administrators, and the Multi-state Tax Commission.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 9
97-LJX-004(1.4)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Update Custom Computer Software. (Public)

Sponsors: Representatives Cansler, Blue, Capps, Church, and Neely.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE SALES TAX DEFINITION OF CUSTOM COMPUTER SOFTWARE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.3(20) reads as rewritten:

"(20) ~~'Tangible personal property' means and includes personal property which~~ Tangible personal property. -- Personal property that may be seen, weighed, measured, ~~felt~~ felt, or touched or is in any other manner perceptible to the senses. The term ~~"tangible personal property" shall~~ does not include stocks, bonds, notes, ~~insurance~~ insurance, or other obligations or securities, nor ~~shall~~ does it include water delivered by or through main lines or pipes either for commercial or domestic use or consumption. The term includes ~~all "canned" or prewritten computer programs, either in the form of written procedures or in the form of storage media on which or in which the program is recorded, held, or existing for general or repeated sale, lease, or license to use or~~

~~consume. The term does not include the design, development, writing, translation, fabrication, lease, license to use or consume, or transfer for a consideration of title or possession of a custom computer program, other than a basic operational program, either in the form of written procedures or in the form of storage media on which or in which the program is recorded, or any required documentation or manuals designed to facilitate the use of the custom computer program. The term also does not include access to a computer program or a database when the user of the computer program or database receives a separately stated fee or other charge for the access.~~

~~As used in this subdivision:~~

~~a. "Basic operational program" or "control program" means a computer program that is fundamental and necessary to the functioning of a computer. A basic operational program is that part of an operating system, including supervisors, monitors, executives, and control or master programs, which consists of the control program elements of that system. A control or master program, as opposed to a processing program, controls the operation of a computer by managing the allocation of all system resources, including the central processing unit, main storage, input/output devices, and processing programs. A processing program is used to develop and implement the specific applications the computer is to perform.~~

~~b. "Computer program" means the complete plan for the solution of a problem, such as the complete sequence of automatic data-processing equipment instructions necessary to solve a problem, and includes both systems and application programs and subdivisions, such as assemblers, compilers, routines, generators, and utility programs.~~

~~c. "Custom computer program" means a computer program prepared to the special order of the~~

~~customer. Custom computer programs include one of the following elements:~~

~~1. Preparation or selection of the programs for the customer's use requires an analysis of the customer's requirements by the vendor; or~~

~~2. The program requires adaptation by the vendor to be used in a particular make and model of computer utilizing a specified output device.~~

~~d. "Storage media" means punched cards, tapes, disks, diskettes, or drums.~~

computer software delivered on a storage medium, such as a cd rom, a disk, or a tape."

Sec. 2. G.S. 105-164.13 is amended by adding a new subdivision to read:

"(43) Custom computer software. -- 'Custom computer software' is software written in accordance with the specifications of a specific customer. The term does not include prewritten software that is held or exists for general or repeated sale or lease, even if the prewritten program was initially developed on a custom basis or for in-house use.

Modification of a prewritten program to meet a customer's needs is custom computer software only to the extent of the modification, unless the charge for modifying the program exceeds fifty percent (50%) of the total charge for the program. If the charge for modifying the program exceeds this threshold, the entire program is considered to be custom computer software. To be exempt from tax, a charge for modifying a prewritten program must be separately stated."

Sec. 3. This act becomes effective October 1, 1997, and applies to sales made on or after that date.

Explanation of Legislative Proposal 4 (97-LJX-004)
Update Custom Computer Software

This bill modifies the sales tax definition of custom computer software to make a clear distinction between software that is subject to State and local sales and use taxes and software that is not subject to these taxes. The bill becomes effective October 1, 1997.

Under current law, canned software is subject to sales and use taxes and custom software is not subject to these taxes. The North Carolina sales and use tax law excludes custom computer software from tax to implement the policy that computer services are not subject to sales and use taxes. The cost for custom computer programs is attributable to the programming services provided rather than the cost of producing a tangible form of the program on a cd rom or tape. The current definition of custom software is very broad, however, and can include off-the counter "shrink-wrap" programs and programs that have been modified only slightly by the vendor.

Under the current definition, custom computer software includes all software recommended to the purchaser by the seller after performing an analysis of the purchaser's needs. Thus, under this definition, a common product such as Microsoft's Word program becomes exempt from sales and use tax if the seller of the program analyzes the customer's needs and decides that Word is better for the customer than WordPerfect or another competing product.

The current definition of custom software also includes all programs adapted by the seller of the program to be used in a particular computer and its associated input/output devices such as printers. This type of adaptation can be slight, such as the completion of a "fill-in-the-blank" series in which the particular hardware to be used with the program is designated, or it can require extensive changes to the lines of code in the software. Under the current definition, any slight modification of a program makes the entire program exempt from State and local sales and use taxes.

The bill changes the definition of custom computer software in two ways. First, it eliminates from the category of custom software all canned or prewritten programs. It does this by deleting an analysis of a customer's needs as a determining factor in whether a program is custom (exempt) or canned (taxable). Second, it allows only part of a program that has been modified to suit a customer's needs to be considered a custom program and therefore exempt from tax. The bill declares that when a program is modified, only the modification and not the rest of the program is considered to be custom. The bill recognizes, however, that major changes to a program merit exclusion of the whole program as a custom program. It does this by declaring that when the charge for a modification exceeds 50% of the cost of the program as modified, then the entire program is considered custom and is exempt from tax.

In making these changes, the bill adopts the approach to taxation of custom software that is applied by the state of California. The bill incorporates the California law as well as the California regulation that establishes the 50% test for determining

when modifications to a program are so extensive that the entire program should be exempt from tax.

Proposal 9: Sales tax on Canned Computer Software

Summary: The act modifies the sales tax definition of custom computer software.

Effective Date: Effective October 1, 1997 and applies to sales made on or after that date.

Fiscal Effect:

No estimate available.

Since the Department of Revenue keeps sales tax data by type of business and not by type of commodity, there is no data on canned versus custom software. The Department believes businesses are taking advantage of ambiguities in the current law to exempt software that should be taxed. Fiscal Research has asked the Department to poll their field auditors for cases where it was ruled that canned software was exempted from sales tax. This information is not available for this report.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 10
97-LC-022(1.1)
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Conform Sales Tax Refund Period. (Public)

Sponsors: Representatives Capps, Blue, Cansler, Church, Neely, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO EXTEND THE TIME ALLOWED GOVERNMENT ENTITIES AND NONPROFIT ENTITIES FOR CLAIMING SALES TAX REFUNDS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.14(d) reads as rewritten:

"(d) Penalties for Late Applications. -- Refunds made pursuant to applications filed after the dates specified in subsections (b) and (c) above are subject to the following penalties for late filing: applications filed within 30 days after the due date, twenty-five percent (25%); applications filed after 30 days but within ~~six months~~ three years after the due date, fifty percent (50%). Refunds applied for more than ~~six months~~ three years after the due date are barred."

Section 2. This act is effective when it becomes law and applies to sales taxes paid on or after January 1, 1994.

Explanation – Conform Sales Tax Refund Period

This proposal would extend from six months to three years the period during which a governmental entity or nonprofit entity may claim a sales tax refund. It would apply to sales taxes paid on or after January 1, 1994.

Under G.S. 105-164.14, nonprofit entities, certain hospitals, and certain governmental entities may seek a refund of State and local sales taxes they pay on their purchases. To do so, these entities must file a written request for refund with the Department of Revenue and name the counties where the purchases were made. Governmental entities must apply for the refund after the end of each fiscal year; other entities must apply for the refund semiannually. The application must be filed within six months. If the application is late, there is a penalty equal to a percentage of the refund claimed. If the application is more than six months late, it is barred.

The Secretary of Revenue has the authority to waive penalties for good cause, but once a refund is barred, the Secretary may not revive it. Frequently, entities whose refund claims are barred ask the General Assembly to enact special legislation giving them an extension of time for filing. At present, there are two churches whose untimely refund claims are barred and who are likely to seek legislation. So that the General Assembly will not have to address individual cases such as these each time they arise, the Department of Revenue has suggested that the statute of limitations be extended from six months to three years, bringing it in line with the general rules of G.S. 105-266 and G.S. 105-266.1, which apply to refunds of overpayments of tax. The Department of Revenue states that the resulting revenue loss should be negligible.

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: Proposal 10
SHORT TITLE: Conform Sales Tax Refund Period
SPONSOR(S): Revenue Laws Study Commission; 1997

FISCAL IMPACT: **Expenditures:** **Increase ( )** **Decrease ( )**
Revenues: **Increase ( )** **Decrease (X)**
No Impact ( )
No Estimate Available ( )

FUND AFFECTED: **General Fund (X)** **Highway Fund ( )** **Local Govt. (X)**
Other Funds ( )

BILL SUMMARY: The proposed act extends the time nonprofit organizations and government entities have to file for sales tax refunds from six months to three years.

EFFECTIVE DATE: Sales taxes paid on or after January 1, 1994.

PRINCIPAL DEPARTMENT(S)/PROGRAM(S) AFFECTED:
Department of Revenue Sales and Use Tax Division

FISCAL IMPACT

	FY 1997-98	FY 1998-99	FY 1999-00	FY 2000-01	FY 2002-01
REVENUES:					
GENERAL FUND	Insignificant loss less than $200,000 in a fiscal year				

ASSUMPTIONS AND METHODOLOGY: The current penalty for filing a late application for refund within 30 days of the due date is 25% of the refund, 50% if the application is filed after 30 days, and if the request is filed six months after the due date the refund is barred. In fiscal year 1995-96, the total of all penalties did not exceed $250,000. In fiscal year 1995-96 18,732 nonprofit entities filed for a refund under G.S. 105-164.14(b) the total amount refunded equaled $153.9 million. Over the same period 740 government entities filed for a refund under G.S. 105-164.14(c) the total amount refunded equaled $56.4 million.

SOURCES OF DATA: Department of Revenue Sales and Use Tax Division

FISCAL RESEARCH DIVISION
733-4910
PREPARED BY: H. Warren Plonk
APPROVED BY:
DATE: January 8, 1997

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S **D**

Legislative Proposal 11
97-LJX-001A(1.5)(Z)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Uniform Tax on Piped Natural Gas. (Public)

Sponsors: Senators Kerr, Cochrane, Cooper, Shaw, and Soles.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ESTABLISH A UNIFORM TAX ON PIPED NATURAL GAS BY CONVERTING THE SALES TAX AND GROSS RECEIPTS TAX ON PIPED NATURAL GAS INTO A TAX BASED ON VOLUME OF THERMS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-116 reads as rewritten:

"**§ 105-116. Franchise or privilege tax on electric power, ~~natural gas,~~ water, and sewerage companies.**

(a) Tax. -- An annual franchise or privilege tax is imposed on a person, firm, or corporation, other than a municipal corporation, that is:

(1) An electric power company engaged in the business of furnishing electricity, electric lights, current, or power.

~~(2) A natural gas company engaged in the business of furnishing piped natural gas.~~

(3) A water company engaged in owning or operating a water system subject to regulation by the North Carolina Utilities Commission.

(4) A public sewerage company engaged in owning or operating a public sewerage system.

The tax on an electric power company is three and twenty-two hundredths percent (3.22%) of the company's taxable gross

receipts from the business of furnishing electricity, electric lights, current, or power. ~~The tax on a natural gas company is three and twenty-two hundredths percent (3.22%) of the company's taxable gross receipts from the business of furnishing piped natural gas.~~ The tax on a water company is four percent (4%) of the company's taxable gross receipts from owning or operating a water system subject to regulation by the North Carolina Utilities Commission. The tax on a public sewerage company is six percent (6%) of the company's taxable gross receipts from owning or operating a public sewerage company. A company's taxable gross receipts are its gross receipts from business inside the State less the amount of gross receipts from sales reported under subdivision (b)(2). A company that engages in more than one business taxed under this section shall pay tax on each business. A company is allowed a credit against the tax imposed by this section for the company's investments in certain entities in accordance with Division V of Article 4 of this Chapter.

(b) Report and Payment. -- The tax imposed by this section is payable monthly or quarterly as specified in this subsection. A report is due quarterly. An electric power company ~~or a natural gas company~~ shall pay tax monthly. A monthly tax payment is due by the last day of the month that follows the month in which the tax accrues, except the payment for tax that accrues in May. The payment for tax that accrues in May is due by June 25. An electric power company ~~or a natural gas company~~ is not subject to interest on or penalties for an underpayment of a monthly amount due if the company timely pays at least ninety-five percent (95%) of the amount due and includes the underpayment with the next report the company files. A water company or a public sewerage company shall pay tax quarterly when filing a report.

A quarterly report covers a calendar quarter and is due by the last day of the month that follows the quarter covered by the report. A company shall submit a report on a form provided by the Secretary. The report shall include the company's gross receipts from all property it owned or operated during the reporting period in connection with its business taxed under this section and shall contain the following information:

(1) The company's gross receipts for the reporting period from business inside and outside this State, stated separately.

(2) The company's gross receipts from commodities or services described in subsection (a) that are sold to a vendee subject to the tax levied by this section or to a joint agency established under G.S.

Chapter 159B or a municipality having an ownership share in a project established under that Chapter.

(3) The amount of and price paid by the company for commodities or services described in subsection (a) that are purchased from others engaged in business in this State and the name of each vendor.

(4) For an electric power ~~company or a natural gas~~ company, the company's gross receipts from the sale within each municipality of the commodities and services described in subsection (a).

A company shall report its gross receipts on an accrual basis.

~~(c) Gas Special Charges. -- Gross receipts of a natural gas company do not include the following:~~

~~(1) Special charges collected within this State by the company pursuant to drilling and exploration surcharges approved by the North Carolina Utilities Commission, if the surcharges are segregated from the other receipts of the company and are devoted to drilling, exploration, and other means to acquire additional supplies of natural gas for the account of natural gas customers in North Carolina and the beneficial interest in the surcharge collections is preserved for the natural gas customers paying the surcharges under rules established by the Commission.~~

~~(2) Natural gas expansion surcharges imposed under G.S. 62-158.~~

(d) Distribution. -- For the purpose of this subsection, the term "distribution amount" means three and nine hundredths percent (3.09%) of the taxable gross receipts derived during a period by an electric power company ~~and a natural gas company~~ from sales within a municipality of the commodities and services described in subsection (a) of this section. The Secretary shall distribute to each municipality the distribution amount for that municipality for the preceding calendar quarter less ~~an amount equal to~~ the 'hold-back amount' for the municipality. The 'hold-back amount' for a municipality equals one-fourth of the excess of the electric power distribution amount for that municipality for the period April 1, 1994, to March 31, 1995, over the electric power distribution amount for that municipality for the period April 1, 1990, to March 31, 1991, as certified by the Secretary. The Secretary shall distribute the revenue within 75 days after the end of each quarter. If a company's report does not state the company's taxable gross receipts derived within a

municipality, the Secretary shall determine a practical method of allocating part of the company's taxable gross receipts to the municipality.

As used in this subsection, the term "municipality" includes an urban service district defined by the governing board of a consolidated city-county. The amount due an urban service district shall be distributed to the governing board of the consolidated city-county.

(e) Local Tax. -- So long as there is a distribution to municipalities of the amount herein provided from the tax imposed by this section, no municipality shall impose or collect any greater franchise, privilege or license taxes, in the aggregate, on the businesses taxed under this section, than was imposed and collected on or before January 1, 1947. If any municipality shall have collected any privilege, license or franchise tax between January 1, 1947, and April 1, 1949, in excess of the tax collected by it prior to January 1, 1947, then upon distribution of the taxes imposed by this section to municipalities, the amount distributable to any municipality shall be credited with such excess payment."

Sec. 2. G.S. 105-164.3(25) reads as rewritten:

"**§ 105-164.3. Definitions.**

The following definitions apply in this Article, except when the context clearly indicates a different meaning:

(25) 'Utility' means an electric power ~~company, a gas company,~~ company or a telephone company that is subject to a privilege tax based on gross receipts under G.S. 105-116 or 105-120, a business entity that provides local, toll, or private telecommunications service as defined by G.S. ~~105-120(e)~~ 105-120(e), or a municipality that sells electric power, other than a municipality whose only wholesale supplier of electric power is a federal agency and who is required by a contract with that federal agency to make payments in lieu of taxes."

Sec. 3. G.S. 105-164.4(a) reads as rewritten:

"(a) A privilege tax is imposed on a retailer at the following percentage rates of the retailer's net taxable sales or gross receipts, as appropriate. The general rate of tax is four percent (4%).

(1) The general rate of tax applies to the sales price of each item or article of tangible personal

property that is sold at retail and is not subject to tax under another subdivision in this section.

(1a) The rate of two percent (2%) applies to the sales price of each manufactured home sold at retail, including all accessories attached to the manufactured home when it is delivered to the purchaser. The maximum tax is three hundred dollars ($300.00) per article. Each section of a manufactured home that is transported separately to the site where it is to be erected is a separate article.

(1b) The rate of three percent (3%) applies to the sales price of each aircraft, boat, railway car, or locomotive sold at retail, including all accessories attached to the item when it is delivered to the purchaser. The maximum tax is one thousand five hundred dollars ($1,500) per article.

(1c) The rate of one percent (1%) applies to the sales price of the following articles:

a. Horses or mules by whomsoever sold.

b. Semen to be used in the artificial insemination of animals.

c. Sales of fuel, other than ~~electricity or piped natural gas,~~ electricity, to farmers to be used by them for any farm purposes other than preparing food, heating ~~dwellings~~ dwellings, and other household purposes. The quantity of fuel purchased or used at any one time shall not in any manner be a determinative factor as to whether any sale or use of fuel is or is not subject to the one percent (1%) rate of tax imposed ~~herein.~~ by this subdivision.

d. Sales of fuel, other than ~~electricity or piped natural gas,~~ electricity, to manufacturing industries and manufacturing plants for use in connection with the operation of such industries and plants other than sales of fuels to be used for residential heating purposes. The quantity of fuel purchased or used at any one time shall not in any manner be a determinative factor as to whether any sale or use of fuel is or is not subject to the rate of tax provided in this subdivision.

e. Sales of fuel, other than ~~electricity or piped natural gas,~~ electricity, to commercial laundries or to pressing and dry-cleaning establishments for use in machinery used in the direct performance of the laundering or the pressing and cleaning service.

f. Sales to freezer locker plants of wrapping paper, cartons and supplies consumed directly in the operation of such plant.

(1d) The rate of one percent (1%) applies to the sales price of the following articles. The maximum tax is eighty dollars ($80.00) per article.

a. Sales to a farmer of machines and machinery, and parts and accessories for these machines and machinery, for use by the farmer in the planting, cultivating, harvesting, or curing of farm crops or in the production of dairy products, eggs, or animals. A "farmer" includes a dairy operator, a poultry farmer, an egg producer, a livestock farmer, a farmer of crops, and a farmer of an aquatic species, as defined in G.S. 106-758. Items that are exempt from tax under G.S. 105-164.13(4c) are not subject to tax under this section.

The term "machines and machinery" as used in this subdivision is defined as follows:

The term shall include all vehicular implements, designed and sold for any use defined in this subdivision, which are operated, drawn or propelled by motor or animal power, but shall not include vehicular implements which are operated wholly by hand, and shall not include any motor vehicles required to be registered under Chapter 20 of the General Statutes.

The term shall include all nonvehicular implements and mechanical devices designed and sold for any use defined in this subdivision, which have moving parts, or which require the use of any motor or animal power, fuel, or electricity in their operation but shall not include nonvehicular implements which have no moving parts and are operated wholly by hand.

The term shall also include metal flues sold for use in curing tobacco, whether such flues are attached to handfired furnaces or used in connection with mechanical burners.

b. Sales of mill machinery or mill machinery parts and accessories to manufacturing industries and plants, and sales to contractors and subcontractors purchasing mill machinery or mill machinery parts and accessories for use by them in the performance of contracts with manufacturing industries and plants, and sales to subcontractors purchasing mill machinery or mill machinery parts and accessories for use by them in the performance of contracts with general contractors who have contracts with manufacturing industries and plants. As used in this paragraph, the term "manufacturing industries and plants" does not include delicatessens, cafes, cafeterias, restaurants, and other similar retailers that are principally engaged in the retail sale of foods prepared by them for consumption on or off their premises.

c. Sales of central office equipment and switchboard and private branch exchange equipment to telephone companies regularly engaged in providing telephone service to subscribers on a commercial basis, and sales to these companies of prewritten computer programs used in providing telephone service to their subscribers.

d. Sales to commercial laundries or to pressing and dry cleaning establishments of machinery used in the direct performance of the laundering or the pressing and cleaning service and of parts and accessories thereto.

e. Sales to freezer locker plants of machinery used in the direct operation of said freezer locker plant and of parts and accessories thereto.

f. Sales of broadcasting equipment and parts and accessories thereto and towers to commercial radio and television companies which are under

the regulation and supervision of the Federal Communications Commission.

g. Sales to farmers of bulk tobacco barns and racks and all parts and accessories thereto and similar apparatus used for the curing and drying of any farm produce.

h. Sales to farmers of grain, feed or soybean storage facilities and accessories thereto, whether or not dryers are attached, and all similar apparatus and accessories thereto for the storage of grain, feed or soybeans.

i. Sales of containers to farmers or producers for use in the planting, producing, harvesting, curing, marketing, packaging, sale, or transporting or delivery of their products when such containers do not go with and become part of the sale of their products at wholesale or retail.

(1e) The rate of three percent (3%) applies to the sales price of each mobile classroom or mobile office sold at retail, including all accessories attached to the mobile classroom or mobile office when it is delivered to the purchaser. The maximum tax is one thousand five hundred dollars ($1,500) per article. Each section of a mobile classroom or mobile office that is transported separately to the site where it is to be placed is a separate article.

(1f) The rate of two and eighty-three-hundredths percent (2.83%) applies to the sales price of electricity ~~and piped natural gas~~ described in this subdivision and measured by a separate meter or another separate device:

a. Sales of electricity ~~and piped natural gas~~ to farmers to be used by them for any farm purposes other than preparing food, heating dwellings, and other household purposes. The quantity of electricity or gas purchased or used at any one time shall not be a determinative factor as to whether its sale or use is or is not subject to the rate of tax provided in this subdivision.

b. Sales of electricity ~~and piped natural gas~~ to manufacturing industries and manufacturing

plants for use in connection with the operation of the industries and plants other than sales of electricity ~~and gas~~ to be used for residential heating purposes. The quantity of electricity ~~or gas~~ purchased or used at any one time shall not be a determinative factor as to whether its sale or use is or is not subject to the rate of tax provided in this subdivision.

c. Sales of electricity ~~and piped natural gas~~ to commercial laundries or to pressing and dry-cleaning establishments for use in machinery used in the direct performance of the laundering or the pressing and cleaning service.

(2) The applicable percentage rate applies to the gross receipts derived from the lease or rental of tangible personal property by a person who is engaged in the business of leasing or renting tangible personal property, or is a retailer and leases or rents property of the type sold by the retailer. The applicable percentage rate is the rate and the maximum tax, if any, that applies to a sale of the property that is leased or rented. A person who leases or rents property shall also collect the tax imposed by this section on the separate retail sale of the property.

(3) Operators of hotels, motels, tourist homes, tourist camps, and similar type businesses and persons who rent private residences and cottages to transients are considered retailers under this Article. A tax at the general rate of tax is levied on the gross receipts derived by these retailers from the rental of any rooms, lodgings, or accommodations furnished to transients for a consideration. This tax does not apply to any private residence or cottage that is rented for less than 15 days in a calendar year or to any room, lodging, or accommodation supplied to the same person for a period of 90 or more continuous days.

As used in this subdivision, the term "persons who rent to transients" means (i) owners of private residences and cottages who rent to

transients and (ii) rental agents, including "real estate brokers" as defined in G.S. 93A-2, who rent private residences and cottages to transients on behalf of the owners. If a rental agent is liable for the tax imposed by this subdivision, the owner is not liable.

(4) Every person engaged in the business of operating a dry cleaning, pressing, or hat-blocking establishment, a laundry, or any similar business, engaged in the business of renting clean linen or towels or wearing apparel, or any similar business, or engaged in the business of soliciting cleaning, pressing, hat blocking, laundering or linen rental business for any of these businesses, is considered a retailer under this Article. A tax at the general rate of tax is levied on the gross receipts derived by these retailers from services rendered in engaging in any of the occupations or businesses named in this subdivision. The tax imposed by this subdivision does not apply to receipts derived from coin or token-operated washing machines, extractors, and dryers. The tax imposed by this subdivision does not apply to gross receipts derived from services performed for resale by a retailer that pays the tax on the total gross receipts derived from the services.

(4a) The rate of three percent (3%) applies to the gross receipts derived by a utility from sales of ~~electricity, piped natural gas,~~ electricity or local telecommunications service as defined by G.S. 105-120(e), other than sales of electricity ~~or piped natural gas~~ subject to tax under another subdivision in this section. ~~Gross receipts from sales of piped natural gas shall not include natural gas expansion surcharges imposed under G.S. 62-158.~~ A person who operates a utility is considered a retailer under this Article.

(4b) A person who sells tangible personal property at a flea market, other than the person's own household personal property, is considered a retailer under this Article. A tax at the general rate of tax is levied on the sales price of each article sold by the retailer at the flea market. A person who leases or rents space to others at a flea market

may not lease or rent this space unless the retailer requesting to rent or lease the space shows the license or a copy of the license required by this Article or other evidence of compliance. A person who leases or rents space at a flea market shall keep records of retailers who have leased or rented space at the flea market. As used in this subdivision, the term "flea market" means a place where space is rented to a person for the purpose of selling tangible personal property.

(4c) The rate of six and one-half percent (6 1/2%) applies to the gross receipts derived from providing toll telecommunications services or private telecommunications services as defined by G.S. 105-120(e) that both originate from and terminate in the State and are not subject to the privilege tax under G.S. 105-120. Any business entity that provides these services is considered a retailer under this Article. This subdivision does not apply to telephone membership corporations as described in Chapter 117 of the General Statutes.

(5) **(Effective July 1, 1997)** The rate of three percent (3%) applies to the sales price of food that is not otherwise exempt pursuant to G.S. 105-164.13 but would be exempt pursuant to G.S. 105-164.13 if it were purchased with coupons issued under the Food Stamp Program, 7 U.S.C. § 51."

Sec. 4. G.S. 105-164.13 is amended by adding a new subdivision to read:

"(43) Piped natural gas. This item is exempt because it is taxed under Article 5D of this Chapter."

Sec. 5. G.S. 105-164.20 reads as rewritten:

"**§ 105-164.20. Cash or accrual basis of reporting.**

Any retailer, except a utility, ~~taxable under this Article having both cash and credit sales~~ may report ~~such~~ sales on either the cash or accrual basis of accounting upon making application to the Secretary for permission to use ~~such~~ the basis ~~of reporting under such rules and regulations as shall be promulgated from time to time by the Secretary. Such permission shall continue in force and effect unless revoked by the Secretary but he may grant written permission to any such taxpayer upon application therefor to change from one basis to~~

~~another under such rules and regulations. A utility shall~~ selected. Permission granted by the Secretary to report on a selected basis continues in effect until revoked by the Secretary or the taxpayer receives permission from the Secretary to change the basis selected. A utility must report its sales on an accrual basis. A sale by a utility of ~~electricity, piped natural gas,~~ electricity or intrastate telephone service is considered to accrue when the utility bills its customer for the sale."

Sec. 6. Chapter 105 of the General Statutes is amended by adding a new Article to read:

"ARTICLE 5D.

"Piped Natural Gas Tax.

"**§ 105-187.30. Definitions.**

The definitions in G.S. 105-228.90 and the following definitions apply in this Article:

(1) Local distribution company. -- A natural gas company to whom the North Carolina Utilities Commission has issued a franchise under Chapter 62 of the General Statutes to serve an area of this State.

(2) Sales customer. -- An end-user whose piped natural gas is delivered by the seller of the gas.

(3) Transportation customer. -- An end-user whose piped natural gas is delivered by a person who is not the seller of the gas.

"**§ 105-187.32. Tax imposed on piped natural gas.**

(a) Scope. -- An excise tax is imposed on piped natural gas consumed in this State. This tax is imposed in lieu of a sales and use tax and a percentage gross receipts tax on piped natural gas.

(b) Rate. -- The tax rate is set in the table below and is based on monthly therm volumes of piped natural gas received by the consumer of the gas:

Volume of Therms Received During The Month	Rate Per Therm
First 200	$.047
201 to 15,000	.027
Over 15,000	.022

"**§ 105-187.34. Liability for the tax.**

The excise tax imposed by this section on piped natural gas is payable as follows:

(1) For piped natural gas delivered by a local distribution company to a sales customer or a

transportation customer, the tax is payable by the local distribution company.

(2) For piped natural gas delivered to a sales customer by a city, the tax is payable by the city.

(3) For piped natural gas received by a person directly from an interstate pipeline for consumption by that person, the tax is payable by that person.

"**§ 105-187.36. Payment of the tax.**

(a) Monthly Return. -- The tax imposed by this Article is payable monthly to the Secretary. A monthly tax payment is due by the last day of the month that follows the month in which the tax accrues. The tax payable on piped natural gas delivered to a customer by a local distribution company or a city accrues when the gas is delivered. The tax payable on piped natural gas to be consumed by a person who received the gas directly from an interstate pipeline accrues when the person receives the gas.

(b) Small Underpayments. -- A person is not subject to interest on or penalties for an underpayment of a monthly amount due if person timely pays at least ninety-five percent (95%) of the amount due and includes the underpayment with the next return the person files.

"**§ 105-187.38. Distribution of part of tax proceeds to cities.**

(a) City Information. -- A return filed under this Article must indicate the amount of tax attributable to the following:

(1) Piped natural gas delivered during that month to sales or transportation customers in each city in the State.

(2) Piped natural gas consumed during the month in each city in the State by the pipeline recipient of the gas.

If a tax return does not state this information, the Secretary must determine how much of the tax proceeds are to be attributed to each city.

(b) Distribution. -- Within 75 days after the end of each calendar quarter, the Secretary must distribute to the cities part of the tax proceeds collected under this Article during that quarter. The amount to be distributed to a city is one-half of the amount of tax attributable to that city for that quarter under subsection (a) of this section, less the 'hold-back amount' for that city. The 'hold-back amount' for a city is one-fourth of the amount certified by the Secretary as the increase in the amount of piped natural gas tax proceeds distributed to the city during the twelve-month period beginning April 1, 1994, compared

to the amount distributed during the twelve-month period beginning April 1, 1990.

"**§ 105-187.40. Information exchange and information returns.**

(a) Utilities Info. -- The North Carolina Utilities Commission or the Public Staff of that Commission must give the Secretary a list of the entities that receive piped natural gas from an interstate pipeline and any other information available to the Commission that the Secretary asks for in administering the tax imposed by this Article.

(b) Information Return. -- The Secretary may require the operator of an interstate pipeline to report the amount of piped natural gas taken from the pipeline in this State, the persons that received the gas, and the volume received by each person.

"**§ 105-187.42. Records and audits.**

(a) Records. -- A person who is required to file a return under this Article must keep a record of all documents used to determine information provided in the return. The records must be kept for three years after the due date of the return to which the records apply.

(b) Audits. -- The Secretary may audit a person who is required to file a return under this Article."

Sec. 7. G.S. 105-259(b) is amended by adding a new subdivision to read:

"(b) Disclosure Prohibited. -- An officer, an employee, or an agent of the State who has access to tax information in the course of service to or employment by the State may not disclose the information to any other person unless the disclosure is made for one of the following purposes:

(20) To exchange information concerning the tax on piped natural gas imposed by Article 5D of this Chapter with the North Carolina Utilities Commission or the Public Staff of that Commission."

Sec. 8. G.S. 160A-211 is amended by adding a new subsection to read:

"(c) Piped Gas Restriction. -- A city may not levy a privilege license tax on a person who is engaged in the business of supplying piped natural gas and is subject to tax under Article 5D of Chapter 105 of the General Statutes."

Sec. 9. This act becomes effective January 1, 1998.

Explanation of Legislative Proposal 11 (97-LJX-001A)
Uniform Tax on Piped Natural Gas

This bill combines the current taxes on piped natural gas into a single tax and applies the combined tax uniformly to all sales of piped natural gas. Two taxes now apply to piped natural gas. One of these is a gross receipts tax equal to 3.22% of the gross receipts derived by a utility from the business of furnishing piped natural gas. The other tax is a State sales and use tax on sales by a utility of piped natural gas. The sales and use tax rate is 2.83% for certain sales of piped natural gas to industrial users, farmers, and laundries and is 3% for all other sales. This bill eliminates these taxes and replaces them with a per therm tax on piped natural gas, effective January 1, 1998.

The current taxes on piped natural gas apply only to sales by a utility. The reason they apply only to sales by a utility is that they were enacted when only utilities could sell piped natural gas. Federal and state regulation of the piped natural gas industry has changed, however. For some time, these regulations have allowed persons who are not utilities to sell piped natural gas. Sellers who are not utilities use the pipeline infrastructure of the utilities to deliver the gas they sell and they pay a transportation charge to the utilities for this service. As a result of these developments, piped natural gas is increasingly sold by persons who are not utilities.

Several consequences result from the regulatory changes that allow persons who are not utilities to sell piped natural gas. One consequence is an erosion of the State tax base. The State does not collect a gross receipts tax or a sales tax on sales by the gas marketers. A second consequence is that local revenues are reduced. Most of the gross receipts tax on piped natural gas is distributed to the cities. The distribution amount is a tax equal to 3.09% of the gross receipts derived by a utility from sales within the city. A third consequence is that the tax structure violates the tax principles of fairness and neutrality.

The tax structure violates the principle of fairness by applying only to sales by one type of seller. The tax structure violates the principle of neutrality by encouraging customers to buy piped natural gas from marketers rather than from utilities. Customers are encouraged to buy from marketers because the tax structure enables marketers to sell gas more cheaply than utilities. Marketers can sell the gas more cheaply because gas sold by them is not subject to the same taxes that apply to gas sold by the utilities. This produces the anomalous result that the tax structure favors out-of-state marketers over in-state North Carolina utilities.

This bill eliminates the distinction between sales by utilities and sales by others and applies a uniform tax to all piped natural gas consumed in this State. The uniform tax is an excise tax on the gas. The rate is a "declining block" that decreases as the amount of therms of piped gas consumed in a month increases. A declining block tax

rate is used to preserve the current distribution of the tax burden between the three classes of piped gas customers. These three classes are residential, business, and industrial. The current taxes are a percentage of price. The rates for the three classes are also based on price; residential rates are the highest, business rates are in the middle, and industrial rates are the lowest. The combination of rate and tax result in a higher effective rate of tax on residential customers and a lower rate on business and industrial customers.

The bill preserves this distribution of the tax burden and incorporates the lower 2.83% sales and use tax rate on piped natural gas used in manufacturing. It preserves the distribution by having a rate that declines as volume increases. It incorporates the lower sales and use tax rate because that lower rate was used in determining the amount of tax proceeds that need to be generated by the new method to be the equivalent of the current tax.

By making the tax on piped natural gas uniform, some sales of piped gas that are not subject to tax under the current law will become subject to the tax. The sales that will become subject to tax are those made by persons who are not utilities. The group of sales that will become subject to tax consists of the following:

(1) Sales by gas marketers.

(2) Sales to persons who have direct access to the interstate pipeline and are the end-users of the gas. This groups consists of one company -- Panda Rosemary.

(3) Sales by a municipality to its piped gas customers. Eight cities sell piped natural gas. These eight include four that have direct access to the Transco pipeline (Bessemer City, Kings Mountain, Lexington, and Shelby) and four that sell piped gas but do not have direct access (Greenville, Monroe, Rocky Mount, and Wilson). These cities do not pay gross receipts tax or sales tax on their sales even though cities that provide electric service make in-lieu gross receipts tax payments under G.S. 159B-27(c) and are subject to sales tax under G.S. 105-164.4 on their sales of electricity to their customers.

(4) Sales of piped gas by the producer of the gas. This gas is currently exempt from sales tax under G.S. 105-164.13(3) as a product of a mine.

By expanding the tax to include the group of sales listed above, the bill expands the tax base to make it uniform. This expansion will generate more revenue. The bill however, will not generate more revenue than is produced under the current law because the tax rates have been set in the bill at amounts that are designed to match the current tax collections and not the tax collections the state would receive if all gas were taxed uniformly. The effect is that the amount of tax paid is reduced for those who are currently subject to the tax. This reduction is possible because of the expansion in the base.

This bill does not address differences in the tax treatment of piped gas and other fuels, such as fuel oil. Nor does it attempt to change the rate of piped gas to match that in neighboring states.

Section 1 of the bill repeals the special gross receipts tax on regulated utilities that sell piped natural gas. With the repeal of this special gross receipts tax, gas utilities would pay a gross receipts tax under the general gross receipts tax levy in G.S. 105-122.

Sections 2 through 5 of the bill amend the sales and use tax laws to remove piped natural gas companies from the definition of "utility" and to exempt sales of piped natural gas from the tax. These changes are made because Section 6 of this act levies a new tax on piped natural gas that replaces the sales and use tax and the gross receipts tax on this product.

Section 6 imposes a new tax on piped natural gas that replaces the current gross receipts tax and the sales and use tax on piped natural gas provided by utilities.

Section 7 makes a conforming change to the tax "secrecy" restrictions so that the Department of Revenue and the Utilities Commission can exchange information needed to administer the tax.

Section 8 makes a conforming change to the city privilege license tax restrictions to preserve the current prohibition in 105-116 on the levy of a privilege license tax by cities on gas companies.

Section 9 makes the bill effective January 1, 1998.

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Proposal 11
SHORT TITLE: Uniform Tax on Piped Natural Gas
SPONSOR(S): Revenue Laws Study Committee 1997

FISCAL IMPACT: **Expenditures:** **Increase ( )** **Decrease ( )**
Revenues: **Increase ( )** **Decrease ( )**
No Impact (Revenue Neutral)

FUND AFFECTED: **General Fund (x)** **Highway Fund ( )** **Local Govt. ( )**
Other Funds ( )

BILL SUMMARY: The proposed act establishes a uniform tax on piped natural gas by converting the sales tax and gross receipts tax on piped natural into a tax based on therms.

EFFECTIVE DATE: January 1, 1996

PRINCIPAL DEPARTMENT(S)/PROGRAM(S) AFFECTED:
Department of Revenue

FISCAL IMPACT

	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-00	FY 2000-01
REVENUES:					
GENERAL FUND		Revenue Neutral			

FISCAL RESEARCH DIVISION
733-4910
PREPARED BY: H. Warren Plonk
APPROVED BY:
DATE: January 9, 1996

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S D

Legislative Proposal 12
97-LJ-002(1.1)(Z)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Adjust City Receipts Tax Share. (Public)

Sponsors: Senators Cochrane, Cooper, Kerr, Shaw, and Soles.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ADJUST THE SHARE THE CITIES RECEIVE FROM THE STATE GROSS RECEIPTS TAX TO MAKE THE DISTRIBUTION MORE EQUITABLE.

The General Assembly of North Carolina enacts:

Section 1. Article 3 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"§ 105-116.1. Distribution of gross receipts taxes to cities.

(a) Distribution. -- The Secretary shall distribute to the cities part of the taxes collected under this Article on electric power companies, natural gas companies, and telephone companies. Each city's share for a calendar quarter is the percentage distribution amount for that city minus one-fourth of the hold-back amount for that city. The Secretary shall make the distribution within 75 days after the end of each calendar quarter.

(b) Percentage Amount. -- The percentage distribution amount for a city is three and nine hundreths percent (3.09%) of the gross receipts derived during the preceding quarter by an electric power company, a natural gas company, or a telephone company from sales within the city that are taxable under G.S. 105-116 or 105-120.

(c) Hold-back Amount. -- The hold-back amount reflects the amount of growth in the gross receipts taxes that occured during

the 1991-92 through 1994-95 fiscal years, the 'freeze' years. The total amount distributed to cities during that period was fixed at the total amount that would have been distributed during the 1990-91 fiscal year if the Governor had not reduced the distribution for that year as part of the effort to balance the State budget. During the freeze years, cities received a part of the fixed amount based on taxable sales within the cities. For the 1995-96 fiscal year and subsequent years, the limit on the amount distributed was removed and the distribution reverted to its prior percentage basis with the added requirement of deducting the growth that occurred in the freeze years.

The hold-back amount for a city is determined by comparing the amount each city received from gross receipts taxes in the 1995-96 fiscal year and in the 1990-91 fiscal year and then adjusting that amount, if required, in accordance with this subsection. If, in the 1995-96 fiscal year, a city received at least ninety-five percent (95%) of the amount it received in the 1990-91 fiscal year, the hold-back amount for that city is the amount by which the city's 1995-96 percentage distribution amount was reduced. If, in the 1995-96 fiscal year, a city received less than ninety-five percent (95%) of the amount it received in the 1990-91 fiscal year, the hold-back amount for that city is the amount determined by the following calculation:

(1) Increase the city's 1990-91 distribution by adding the amount by which the city's 1995-96 percentage distribution amount was reduced.

(2) Compare the increased 1990-91 amount with the city's 1995-96 distribution.

(3) If the increased 1990-91 distribution is less than or equal to the city's 1995-96 distribution, the hold-back amount for the city is the amount by which the city's 1995-96 distribution amount was reduced.

(4) If the increased 1990-91 distribution is more than the city's 1995-96 distribution, the hold-back amount for the city is the difference between the increased 1990-91 distribution and the 1995-96 distribution."

Sec. 2. G.S. 105-116 reads as rewritten:

"**§ 105-116. Franchise or privilege tax on electric power, natural gas, water, and sewerage companies.**

(a) Tax. -- An annual franchise or privilege tax is imposed on a person, firm, or corporation, other than a municipal corporation, that is:

(1) An electric power company engaged in the business of furnishing electricity, electric lights, current, or power.
(2) A natural gas company engaged in the business of furnishing piped natural gas.
(3) A water company engaged in owning or operating a water system subject to regulation by the North Carolina Utilities Commission.
(4) A public sewerage company engaged in owning or operating a public sewerage system.

The tax on an electric power company is three and twenty-two hundredths percent (3.22%) of the company's taxable gross receipts from the business of furnishing electricity, electric lights, current, or power. The tax on a natural gas company is three and twenty-two hundredths percent (3.22%) of the company's taxable gross receipts from the business of furnishing piped natural gas. The tax on a water company is four percent (4%) of the company's taxable gross receipts from owning or operating a water system subject to regulation by the North Carolina Utilities Commission. The tax on a public sewerage company is six percent (6%) of the company's taxable gross receipts from owning or operating a public sewerage company. A company's taxable gross receipts are its gross receipts from business inside the State less the amount of gross receipts from sales reported under subdivision (b)(2). A company that engages in more than one business taxed under this section shall pay tax on each business. A company is allowed a credit against the tax imposed by this section for the company's investments in certain entities in accordance with Division V of Article 4 of this Chapter.

(b) Report and Payment. -- The tax imposed by this section is payable monthly or quarterly as specified in this subsection. A report is due quarterly. An electric power company or a natural gas company shall pay tax monthly. A monthly tax payment is due by the last day of the month that follows the month in which the tax accrues, except the payment for tax that accrues in May. The payment for tax that accrues in May is due by June 25. An electric power company or a natural gas company is not subject to interest on or penalties for an underpayment of a monthly amount due if the company timely pays at least ninety-five percent (95%) of the amount due and includes the underpayment with the next report the company files. A water company or a public sewerage company shall pay tax quarterly when filing a report.

A quarterly report covers a calendar quarter and is due by the last day of the month that follows the quarter covered by the

report. A company shall submit a report on a form provided by the Secretary. The report shall include the company's gross receipts from all property it owned or operated during the reporting period in connection with its business taxed under this section and shall contain the following information:

(1) The company's gross receipts for the reporting period from business inside and outside this State, stated separately.

(2) The company's gross receipts from commodities or services described in subsection (a) that are sold to a vendee subject to the tax levied by this section or to a joint agency established under G.S. Chapter 159B or a ~~municipality~~ city having an ownership share in a project established under that Chapter.

(3) The amount of and price paid by the company for commodities or services described in subsection (a) that are purchased from others engaged in business in this State and the name of each vendor.

(4) For an electric power company or a natural gas company, the company's gross receipts from the sale within each ~~municipality~~ city of the commodities and services described in subsection (a).

A company shall report its gross receipts on an accrual basis. If a company's report does not state the company's taxable gross receipts derived within a city, the Secretary must determine a practical method of allocating part of the company's taxable gross receipts to the city.

(c) Gas Special Charges. -- Gross receipts of a natural gas company do not include the following:

(1) Special charges collected within this State by the company pursuant to drilling and exploration surcharges approved by the North Carolina Utilities Commission, if the surcharges are segregated from the other receipts of the company and are devoted to drilling, exploration, and other means to acquire additional supplies of natural gas for the account of natural gas customers in North Carolina and the beneficial interest in the surcharge collections is preserved for the natural gas customers paying the surcharges under rules established by the Commission.

(2) Natural gas expansion surcharges imposed under G.S. 62-158.

(d) Distribution. -- ~~For the purpose of this subsection, the term "distribution amount" means three and nine hundredths percent (3.09%) of the taxable gross receipts derived during a period by an electric power company and a natural gas company from sales within a municipality of the commodities and services described in subsection (a) of this section. The Secretary shall distribute to each municipality the distribution amount for that municipality for the preceding calendar quarter less an amount equal to one-fourth of the excess of the distribution amount for that municipality for the period April 1, 1994, to March 31, 1995, over the distribution amount for that municipality for the period April 1, 1990, to March 31, 1991, as certified by the Secretary. The Secretary shall distribute the revenue within 75 days after the end of each quarter. If a company's report does not state the company's taxable gross receipts derived within a municipality, the Secretary shall determine a practical method of allocating part of the company's taxable gross receipts to the municipality.~~

~~As used in this subsection, the term "municipality" includes an urban service district defined by the governing board of a consolidated city-county. The amount due an urban service district shall be distributed to the governing board of the consolidated city-county.~~ Part of the taxes imposed by this section on electric power companies and natural gas companies is distributed to cities under G.S. 105-116.1.

(e) Local Tax. -- So long as there is a distribution to ~~municipalities of the amount herein provided~~ cities from the tax imposed by this section, no ~~municipality~~ city shall impose or collect any greater franchise, privilege or license taxes, in the aggregate, on the businesses taxed under this section, than was imposed and collected on or before January 1, 1947. If any municipality shall have collected any privilege, license or franchise tax between January 1, 1947, and April 1, 1949, in excess of the tax collected by it prior to January 1, 1947, then upon distribution of the taxes imposed by this section to municipalities, the amount distributable to any municipality shall be credited with such excess payment."

Sec. 3. G.S. 105-120 reads as rewritten:

"**§ 105-120. Franchise or privilege tax on telephone companies.**

(a) Tax. -- An annual franchise or privilege tax is imposed on a person, firm, or corporation, that owns or operates a business entity for the provision of local telecommunications service. The tax is three and twenty-two hundredths percent (3.22%) of the company's taxable gross receipts. A company's taxable gross

receipts are its receipts from providing local telecommunications service, including receipts from rentals and other similar charges, less its receipts from telecommunications access charges. A company is allowed a credit against the tax imposed by this section for the company's investments in certain entities in accordance with Division V of Article 4 of this Chapter.

(b) Report and Payment. -- The tax imposed by this section is payable monthly or quarterly as specified in this subsection. A report is due quarterly. A company that is liable for an average of less than three thousand dollars ($3,000) a month in tax imposed by this section may, with the approval of the Secretary of Revenue, pay tax quarterly when filing a report. All other companies shall pay tax monthly. A monthly tax payment is due by the last day of the month that follows the month in which the tax accrues, except the payment for tax that accrues in May. The payment for tax that accrues in May is due by June 25. A company is not subject to interest on or penalties for an underpayment of a monthly amount due if the company timely pays at least ninety-five percent (95%) of the amount due and includes the underpayment with the next report the company files.

A quarterly report covers a calendar quarter and is due by the last day of the month that follows the quarter covered by the report. A company shall submit a report on a form provided by the Secretary. The report shall state the company's gross receipts for the reporting period from providing local telecommunications service and from providing local telecommunications service within each ~~municipality~~ city served. If a company's report does not state the company's taxable gross receipts derived within a city, the Secretary must determine a practical method of allocating part of the company's taxable gross receipts to the city. A company shall report its gross receipts on an accrual basis.

(c) Distribution. -- ~~For the purpose of this subsection, the term "distribution amount" means three and nine hundredths percent (3.09%) of the taxable gross receipts derived during a period from local telecommunications service provided within a municipality. The Secretary shall distribute to each municipality the distribution amount for that municipality for the preceding calendar quarter less an amount equal to one-fourth of the excess of the distribution amount for that municipality for the period April 1, 1994, to March 31, 1995, over the distribution amount for that municipality for the period April 1, 1990, to March 31, 1991, as certified by the Secretary. The Secretary shall distribute the revenue within 75 days after the~~

~~end of each quarter. If a company's report does not state the company's taxable gross receipts derived within a municipality, the Secretary shall determine a practical method of allocating part of the company's taxable gross receipts to the municipality. As used in this subsection, the term "municipality" includes an urban service district defined by the governing board of a consolidated city-county. The amount due an urban service district shall be distributed to the governing board of the consolidated city-county.~~ Part of the tax imposed by this section is distributed to cities under G.S. 105-116.1.

(d) No Local Tax. -- Counties and cities may not impose a license, franchise, or privilege tax on a company taxed under this section or under G.S. 105-164.4(a)(4c).

(e) Definitions. -- For purposes of this section:

(1) "Local telecommunications service" means telecommunications service provided wholly within a LATA entitling the user to access to a local telephone exchange for the privilege of telephonic quality communication with substantially all persons in the local telephone exchange. Provided, however, local telecommunications service does not include intraLATA or interLATA toll telecommunications service, or private telecommunications service.

(2) "LATA" is a Local Access and Transport Area representing a geographical area comprising one or more telephone exchange areas.

(3) "InterLATA telecommunications" is telecommunications service provided between two or more LATAs.

(4) "Toll telecommunications service" means:

a. A telephonic quality communication for which:

1. There is a toll charge that varies in amount with the distance and elapsed transmission time of each individual communication; and

2. The charge is paid within the United States.

b. A service that entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the

persons having telephone or radiotelephone stations in a specified area that is outside the local telephone exchange.

(5) "Private telecommunications service" means a service furnished to a subscriber that entitles the subscriber to exclusive or priority use of a communications channel or group of channels.

(6) "Telecommunications access charges" means charges paid to a provider of local telecommunications service for access to an interconnection with the local telephone exchange."

Sec. 4. If the hold-back amount of a city is adjusted under G.S. 105-116.1(c), as enacted by this act, the Secretary must distribute two times the amount of the adjustment to the city by July 15, 1997. This distribution is made to restore to the affected cities the amount by which their hold-back would have been reduced if the adjustment had been in effect since the 1995-96 fiscal year. The amount needed to make the distribution required by this section shall be drawn from the amount of gross receipts taxes imposed by G.S. 105-116 and otherwise retained by the State.

Sec. 5. This act is effective when it becomes law.

Explanation of Legislative Proposal 12 (97-LJ-002)
Adjust City Receipts Tax Share

This bill increases the amount of State franchise tax that is distributed to certain cities. The cities whose distribution is increased are those that received less from the distribution in 1995-96 than they did from the distribution in 1990-91 and whose decline in the amount received is attributable to the deduction made from the amount to be distributed for growth that occurred from 1990-91 through 1994-95. The bill is effective upon ratification and applies to distributions made for fiscal year 1995-96 and subsequent years.

The specific cities affected and the counties in which these cities are located are as follows:

CITY	COUNTY
Alexander Mills	Rutherford
Boonville	Yadkin
Bryson City	Swain
Cleveland	Rowan
Denton	Davidson
Grover	Cleveland
Madison	Rockingham
Marshall	Madison
Mount Pleasant	Cabarrus
Polkville	Cleveland
Spindale	Rutherford
Staley	Randolph
Stallings	Union
Tryon	Polk

The State distributes part of the State franchise tax imposed on utilities to the cities. The franchise taxes that are distributed are the taxes on electricity, piped natural gas, and telephone service. The State imposes a franchise tax on these utilities at the rate of 3.22%. The State distributes to cities the amount of tax collected from service provided inside the cities that equals a tax of 3.09%. Thus, the cities receive the majority of these taxes.

The amount to be distributed to a city is reduced by that city's "hold-back" amount. The "hold-back" amount is the amount by which the city's distribution of these franchise taxes increased from fiscal year 1990-91 to fiscal year 1994-95. During this period, the total amount distributed was frozen but the relative share of each city changed. When the freeze was lifted in 1995-96, a requirement was imposed to calculate and deduct a "hold-back" amount.

The "hold-back" amount reduced the amount to be distributed to some cities below the amount that was distributed in 1990-91. This occurred when growth occurred in the city between 1990-91 and 1994-95 and, for whatever reason, was no longer present in 1995-96. If a city's share is reduced below its 1990-91 level because of the hold-back, this bill will increase its share to the amount received in 1990-91.

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: PROPOSAL #12

SHORT TITLE: ADJUST CITY RECEIPTS TAX SHARE

SPONSOR(S):

FISCAL IMPACT: Expenditures: Increase ( ) Decrease ( )
Revenues: Increase (X) Decrease (X)
No Impact ( )
No Estimate Available ( )

FUNDS AFFECTED: General Fund (X) Highway Fund ( ) Local Fund (X)
Other Fund ( )

BILL SUMMARY: Prior to the 1989-90 fiscal year, the portion of the State Franchise tax on the gross receipts of utilities that was shared with municipalities was earmarked from taxes collected. In June, 1990 legislation was enacted to fund the State aid through an appropriation. During the 1991 budget crisis the General Assembly froze the statewide distribution for all future years at the 1990-91 level. Under this system, each city received a share of the statewide frozen amount based on utility taxes collected in the city, relative to the statewide total. The 1993 General Assembly enacted legislation, effective beginning with the 1995-96 fiscal year, that changed the funding system back to an earmarking of the State tax, less a holdback equal to the growth in actual collections for each city between 1990-91 and 1994-95. (The intent was to allow the State to keep the growth in collections during the freeze period as part of the local government contribution to the 1991 budget crisis).

The first-year implementation of the change has identified an issue that affects a handful of cities. The problem occurs in situations is which the utility gross receipts in a city increased between 1990-91 and 1994-95 as a result of the location or expansion of a large taxpayer (i.e., manufacturer) who was not part of the 1995-96 tax base (or at a much lower level). In this situation the city not only loses current revenues but is penalized by a holdback that includes the prior growth of a taxpayer who no longer is part of the city (or at a much lower level).

The proposal corrects this inequity by reducing the holdback for any city whose 1995-96 distribution is at least 5% lower than the 1990-91 distribution, if the application of the holdback moves the city into the negative growth status. The holdback reduction is the amount necessary to ensure that the city is held harmless at the 1990-91 amount. Any adjustment to the holdback portion of the 1995-96 distribution will be carried forward

to all future years. This adjustment does not affect cities whose 1995-96 distribution is lower than 1990-91 for reasons other than the application of the holdback.

An example of the adjustment for a hypothetical city is shown on the attachment.

EFFECTIVE DATE: Upon ratification.

PRINCIPAL DEPARTMENT(S)/PROGRAM(S) AFFECTED: The distribution is administered by the Department of Revenue. It is not anticipated that the legislation will affect the Department's budget requirements.

FISCAL IMPACT

	FY97	FY98	FY99	FY00	FY01
REVENUES/RECEIPTS					
State:	-264,000	-132,000	-132,000	-132,000	-132,000
Cities*:	+264,000	+132,000	+132,000	+132,000	+132,000

*Total for the few cities impacted.

DATA, ASSUMPTIONS, METHODOLOGY: The cost estimate is based on an FRD computer simulation of the proposed system using actual data furnished by the Department of Revenue for the 1990-91 through 1995-96 fiscal year for all cities receiving a distribution.

TECHNICAL CONSIDERATIONS:

FISCAL RESEARCH DIVISION
733-4910
PREPARED BY: Dave Crotts
APPROVED BY:
DATE: December 27 , 1996
[FRD#003]

EXAMPLE: A MAJOR MANUFACTURING PLANT BEGINS OPERATION IN CITY A IN 1992-93 AND CEASES OPERATIONS IN 1995-96.

Utility Tax Collected

	90-91	91-92	92-93	93-94	94-95	95-96	90-91 vs. 95-96
City A	$10.00	$10.05	$15.10	$15.40	$15.70	$10.25	2.5%
Rest of State	$1,000.00	$1,050.00	$1,102.50	$1,157.63	$1,215.51	$1,276.28	27.6%
Total	$1,010.00	$1,060.05	$1,117.60	$1,173.03	$1,231.21	$1,286.53	27.4%
City A Share of Total	0.99%	0.95%	1.35%	1.31%	1.28%	0.80%	
Rest of State Share	99.01%	99.05%	98.65%	98.69%	98.72%	99.20%	

Distribution Under Freeze

	90-91	91-92	92-93	93-94	94-95	95-96	90-91 vs. 95-96
City A	$10.00	$9.58	$13.65	$13.26	$12.88	$4.55 *	-54.5%
Rest of State	$1,000.00	$1,000.42	$996.35	$996.74	$997.12	$1,060.78	6.1%
Total	$1,010.00	$1,010.00	$1,010.00	$1,010.00	$1,010.00	$1,065.33	5.5%
City A Share of Total	0.99%	0.95%	1.35%	1.31%	1.28%	0.43%	
Rest of State Share	99.01%	99.05%	98.65%	98.69%	98.72%	99.57%	

Impact of Proposal

	90-91	91-92	92-93	93-94	94-95	95-96	90-91 vs. 95-96
City A	$10.00	$9.58	$13.65	$13.26	$12.88	$10.00	0.0%
Rest of State	$1,000.00	$1,000.42	$996.35	$996.74	$997.12	$1,060.78	6.1%
Total	$1,010.00	$1,010.00	$1,010.00	$1,010.00	$1,010.00	$1,070.78	6.0%
City A Share of Total	0.99%	0.95%	1.35%	1.31%	1.28%	0.93%	
Rest of State Share	99.01%	99.05%	98.65%	98.69%	98.72%	99.07%	

*$10.25 in Utility Tax Collected less $5.70 in holdback.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H **D**

Legislative Proposal 13
97-LJ-009(1.1)(Z)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Simplify and Reduce Inheritance Tax. (Public)

Sponsors: Representives Cansler, Blue, Capps, Church, Neely, Robinson, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO SIMPLIFY AND REDUCE INHERITANCE TAXES.

The General Assembly of North Carolina enacts:

Section 1. Article 1 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-6.1. Phaseout of inheritance tax.**

When this Article imposes an inheritance tax on property transferred by a decedent but no state death tax credit is allowed under section 2011 of the Code against federal estate tax due on the transfer of the decedent's estate, the amount of inheritance tax is reduced by the appropriate percentage in the phaseout table set out below. When this Article imposes an inheritance tax on property transferred by a decedent and a state death tax credit is allowed under section 2011 of the Code against federal estate tax due on the transfer of the decedent's estate, the amount of inheritance tax that exceeds the maximum credit for state death taxes is reduced by the appropriate percentage in the following phaseout table:

Calendar Year of Decedent's Death	Percentage Reduction
1998	20%
1999	40%

2000	60%
2001	80%
2002 and after	100%."

Sec. 2. Effective January 1, 2002, Article 1 of Chapter 105 of the General Statutes is repealed.

Sec. 3. Effective January 1, 2002, Chapter 105 of the General Statutes is amended by adding a new Article to read:

"ARTICLE 1A.

"Estate Taxes.

"**§ 105-32.1. Definitions.**

The following definitions apply in this Article:

(1) Code. -- Defined in G.S. 105-228.90.

(2) Personal representative. -- The person appointed by the clerk of superior court under Chapter 28A of the General Statutes to administer the estate of a decedent or, if no one is appointed under that Chapter, the person required to file a federal estate tax return for the estate of the decedent.

(3) Secretary. -- Defined in G.S. 105-228.90.

"**§ 105-32.2. Estate tax imposed in amount equal to federal state death tax credit.**

(a) Tax. -- An estate tax is imposed on the estate of a decedent when a federal estate tax is imposed on the estate under section 2001 of the Code and any of the following apply:

(1) The decedent was a resident of this State at death.

(2) The decedent was not a resident of this State at death and owned any of the following:

a. Real property or tangible personal property that is located in this State.

b. Intangible personal property that has a tax situs in this State.

(b) Amount. -- The amount of the estate tax imposed by this section is the maximum credit for state death taxes allowed under section 2011 of the Code. If any property in the estate is located in a state other than North Carolina, the amount of tax payable is the North Carolina percentage of the credit.

If the decedent was a resident of this State at death, the North Carolina percentage is the net value of the estate that does not have a tax situs in another state, divided by the net value of all property in the estate. If the decedent was not a resident of this State at death, the North Carolina percentage is the net value of real property that is located in North Carolina plus the net value of any personal property that has a tax situs in North Carolina, divided by the net value of all property in

the estate, unless the decedent's state of residence uses a different formula to determine that state's percentage. In that circumstance, the North Carolina percentage is the amount determined by the formula used by the decedent's state of residence.

The net value of property that is located in or has a tax situs in this State is its gross value reduced by any debt secured by that property. The net value of all the property in the estate is its gross value reduced by any debts and deductions of the estate.

"§ 105-32.3. Liability for estate tax.

(a) Primary. -- The tax imposed by this Article is payable from the assets of the estate. A person who receives property from an estate is liable for the amount of estate tax attributable to that property.

(b) Personal Representative. -- The personal representative of an estate is liable for an estate tax that is not paid within two years after it was due. This liability is limited to the value of the assets of the estate that were under the control of the personal representative. The amount for which the personal representative is liable may be recovered from the personal representative or from the surety on any bond filed by the personal representative under Article 8 of Chapter 28A of the General Statutes.

(c) Clerk of Court. -- A clerk of court who allows a personal representative to make a final settlement of an estate without presenting one of the following is liable on the clerk's bond for any estate tax due:

(1) An affirmation by the personal representative certifying that no tax is due on the estate because this Article does not require an estate tax return to be filed for that estate.

(2) A certificate issued by the Secretary stating that the tax liability of the estate has been satisfied.

"§ 105-32.4. Payment of estate tax.

(a) Due Date. -- The estate tax imposed by this Article is due when an estate tax return is due. An estate tax return is due on the date a federal estate tax return is due.

(b) Filing Return. -- An estate tax return must be filed under this Article if a federal estate tax return is required. The return must be filed by the personal representative of the estate on a form provided by the Secretary.

(c) Extension. -- An extension of time to file a federal estate tax return is an automatic extension of the time to file

an estate tax return under this Article. The Secretary may, in accordance with G.S. 105-263, extend the time for paying the estate tax imposed by this Article or for filing an estate tax return.

(d) Interest and Penalties. -- The penalties in G.S. 105-236 apply to the failure to file an estate tax return or to pay an estate tax when due. Interest at the rate set in G.S. 105-241.1 accrues on estate taxes paid after the date they are due.

(e) Obtaining Amount Due. -- The personal representative of an estate may sell assets in the estate to obtain money to pay the tax imposed by this Article.

"§ 105-32.5. Making installment payments of tax due when federal estate tax is payable in installments.

A personal representative who elects under section 6166 of the Code to make installment payments of federal estate tax may elect to make installment payments of the tax imposed by this Article. An election under this section extends the time for payment of the tax due in accordance with the extension elected under section 6166 of the Code. Payments of tax are due under this section at the same time and in the same proportion to the total amount of tax due as payments of federal estate tax under section 6166 of the Code. Acceleration of payments under section 6166 of the Code accelerates the payments due under this section.

"§ 105-32.6. Estate tax is a lien on real property in the estate.

The tax imposed by this Article on an estate is a lien on the real property in the estate and on the proceeds of the sale of the real property in the estate. The lien is extinguished when one of the following occurs:

(1) The personal representative certifies to the clerk of court that no tax is due on the estate because this Article does not require an estate tax return to be filed for that estate.

(2) The Secretary issues a certificate stating that the tax liability of the estate has been satisfied.

(3) For specific real property, when the Secretary issues a tax waiver for that property.

(4) Ten years have elapsed since the date of the decedent's death.

"§ 105-32.7. Generation-skipping transfer tax.

(a) Tax. -- A tax is imposed on a generation-skipping transfer that is subject to the tax imposed by Chapter 13 of Subtitle B of the Code when any of the following apply:

(1) The original transferor is a resident of this State at the date of the original transfer.

(2) The original transferor is not a resident of this State at the date of the original transfer and the transfer includes any of the following:

a. Real or tangible personal property that is located in this State.

b. Intangible personal property that has a tax situs in this State.

(b) Amount. -- The amount of the tax imposed by this section is the maximum credit for state generation-skipping transfer taxes allowed under section 2604 of the Code. If property in the transfer is located in a state other than North Carolina, the amount of tax payable is the North Carolina percentage of the credit.

If the original transferor was a resident of this State at the date of the original transfer, the North Carolina percentage is the net value of the property transferred that does not have a tax situs in another state, divided by the net value of all property transferred. If the original transferor was not a resident of this State at the date of the original transfer, the North Carolina percentage is the net value of real property that is located in North Carolina plus the net value of any personal property that has a tax situs in North Carolina, divided by the net value of all property transferred, unless the original transferor's state of residence uses a different formula to determine that state's percentage. In that circumstance, the North Carolina percentage is the amount determined by the formula used by the original transferor's state of residence.

The net value of property that is located in or has a tax situs in this State is its gross value reduced by any debt secured by that property. The net value of all the property in a transfer is its gross value reduced by any debts secured by the property.

(c) Payment. -- The tax imposed by this section is due when a return is due. A return is due the same date as the federal return for payment of the federal generation-skipping transfer tax. The tax is payable by the person who is liable for the federal generation-skipping transfer tax.

"§ 105-32.8. Federal determination that changes the amount of tax payable to the State.

If the federal government corrects or otherwise determines the amount of the maximum state death tax credit allowed an estate under section 6166 of the Code, the personal representative must, within two years after being notified of the correction or final

determination by the federal government, file an estate tax return with the Secretary reflecting the correct amount of tax payable under this Article. If the federal government corrects or otherwise determines the amount of the maximum state generation-skipping transfer tax credit allowed under section 2604 of the Code, the person who made the transfer must, within two years after being notified of the correction or final determination by the federal government, file a tax return with the Secretary reflecting the correct amount of tax payable under this Article.

The Secretary must assess and collect any additional tax due as provided in Article 9 of this Chapter and must refund any overpayment of tax as provided in Article 9 of this Chapter. A person who fails to report a federal correction or determination in accordance with this section is subject to the penalties in G.S. 105-236 and forfeits the right to any refund due by reason of the determination."

Sec. 4. This act does not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended or repealed by this act before the effective date of its amendment or repeal; nor does it affect the right to any refund or credit of a tax that was available under the amended or repealed statute before the effective date of its amendment or repeal.

Sec. 5. Section 1 of this act becomes effective January 1, 1998, and applies to the estates of decedents dying on or after that date. Sections 2 and 3 of this act become effective January 1, 2002, and apply to the estates of decedents dying on or after that date. The remainder of this act is effective upon ratification.

Explanation of Legislative Proposal 13 (97-LJ-009)
Simplify and Reduce Inheritance Tax

This bill phases out the State inheritance tax over five years and retains a State estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of State estate tax is known as a "pick-up" tax because it picks up for the State the amount of federal estate tax that would otherwise be paid to the federal government. The phase out begins in calendar year 1998 and is complete in calendar year 2002. The phase out reduces the amount of inheritance tax payable by 20% each year.

North Carolina imposes an inheritance tax on property transferred by a decedent. The amount of tax payable depends on the relationship of the person transferring the property (the decedent) to the person receiving the property (the beneficiary). This is in contrast to federal law, which has a single rate schedule for estates.

State law classifies beneficiaries into three classes, Class A, Class B, and Class C, and sets different inheritance tax rates for each class. A Class A beneficiary is a lineal ancestor, a lineal descendant, an adopted child, a step-child, or a son-in-law or daughter-in-law whose spouse is not entitled to any of the decedent's property. A Class B beneficiary is a sibling, a descendant of a sibling, or an aunt or uncle by blood. A Class C beneficiary is anyone who is not a Class A or Class B beneficiary.

Class A beneficiaries have the lowest inheritance tax rates and a $600,000 inheritance tax exemption. Class B beneficiaries have higher rates and no exemption. Class C beneficiaries have the highest rates and no exemption. Thus, North Carolina's rate structure favors transfers to children and parents by giving those transfers the lowest rates plus an exemption and prefers transfers to other close family members over transfers to more distant relatives or to persons who are not related.

Federal estate tax allows a $600,000 exemption against the total estate. The State's Class A exemption mirrors this for State inheritance tax.

The bill reduces the State inheritance tax liability by 20% a year until the tax is phased out completely. This liability is not reduced below the amount of the federal estate death tax credit, however. Therefore, the amount of tax paid by a person who is subject to State inheritance tax but not the federal estate tax will be reduced by 20% in calendar year 1998 and then successively higher percentages. The amount paid by a person who owes federal estate tax and North Carolina inheritance tax will be reduced by 20% of the difference between the amount of inheritance tax owed and the amount of the federal state death tax credit. Class B and Class C beneficiaries are the groups likely to owe inheritance tax but not federal estate tax because they have no State exemption comparable to the federal.

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: Proposal 13
SHORT TITLE: Simplify and Reduce Inheritance Tax
SPONSOR(S): 1997 Revenue Laws Study Committee

FISCAL IMPACT: **Expenditures:** **Increase ( )** **Decrease ( )**
Revenues: **Increase ( )** **Decrease (X)**

FUND AFFECTED: **General Fund (X)** **Highway Fund ( )** **Local Govt. ( )**
Other Funds ( )

BILL SUMMARY: The proposed act repeals the State inheritance tax over a five year period and makes clarifying changes governing the imposition of an estate tax.

If the federal state death tax credit is greater than the State inheritance tax then the difference between the two is the State Estate Tax. The **State Estate Tax** is added to the **inheritance tax** to determine the North Carolina total tax due. (A beneficiary would pay to the State an inheritance tax and an estate tax if the inheritance tax were less than the federal state death tax credit.) Federal law requires that an amount equal to the state death tax credit be paid, if not to the State then to the federal government. When the federal state death tax credit is less than the State **inheritance tax** then the net tax owed the State is the **inheritance tax**. The proposed act eliminates an inheritance tax over a five year period.

The federal government allows a tax credit of $192,000 which is equal to an exemption of $600,000. North Carolina allows a tax credit of $33,150 which is equal to a $600,000 exemption for one Class A beneficiary. Under current law, Class B and C beneficiaries are not allowed any credit.

EFFECTIVE DATE: The inheritance tax is repealed effective 1, 2002.

PRINCIPAL DEPARTMENT(S)/PROGRAM(S) AFFECTED:
Office of Examinations of the NC. Department of Revenue

ESTIMATE
FISCAL IMPACT
Preliminary Revenue Impact: 12/19/96

	FY 97-98	FY 98-99	FY 99-00	FY 00-01	FY 01-02
GENERAL FUND REVENUES:					
Inheritance	$ (22.76)	(48.16)	(76.44)	(94.36)	(142.6)

ASSUMPTIONS AND METHODOLOGY:
The estimated revenue loss for fiscal year 1997-98 is 20% of $107.6 the expected revenue from the inheritance tax collections in FY 1997-98. Collections for FY 95-96, equaled $112.9 million and the estate tax pick-up is approximately 10% of total tax collections. The base data $107.5 million, is the product of $112.9 million reduced by $11.29 and increased by the expected growth in state personal income (5.8%). The impact associated with each fiscal year after FY 1997-98, is the expected revenue from the inheritance tax reduced by the appropriate calendar year percentages outlined in the proposed act.

The actual revenue loss is very volatile and depends on the following unknowns:

1. Increases in the federal equivalent exemption
2. The number of taxpayers in the state dying
   a. The size of these estates

SOURCES OF DATA:
Department of Revenue
Federal and State Inheritance Tax Returns
DRI, Forecast of State Personal Income

TECHNICAL CONSIDERATIONS:
The expected loss from increasing the Class A exemption from $500,000 to $600,000 has not been factored in as an attempt to reduce the margin of error in the impact of this proposal. The change is effective for estates of decedents dying on or after January 1, 1997. The loss associated with the 1996 tax law change was approximately $1.5 million for FY 1997-98, $1.6 million for FY 1998-99, $2.0 million for 1999-00, $2.1 million for FY 2000-01, and $2.2 million for FY 2001-02.

FISCAL RESEARCH DIVISION
PREPARED BY: H. Warren Plonk
DATE: January 8, 1997

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

H D

Legislative Proposal 14
97-RBZ-022(1.1)

Short Title: Accounting for 911 Surcharges. (Public)

Sponsors: Representatives Shubert, Blue, Cansler, Capps, Church, Neely, and Robinson.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REQUIRE LOCAL GOVERNMENTS TO ACCOUNT FOR 911 SURCHARGES IN THEIR ANNUAL FINANCIAL STATEMENTS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 62A-7 reads as rewritten:

"**§ 62A-7. Emergency Telephone System Fund.**

The fiscal officer to whom 911 charges are remitted under G.S. 62A-6 shall deposit the charges in a ~~separate, restricted fund.~~ special revenue fund pursuant to G.S. 159-26(b)(2). The Fund shall be known as the Emergency Telephone System Fund. The fiscal officer may invest money in the Fund in the same manner that other money of the local government may be invested. The fiscal officer shall deposit any income earned from such an investment in the Emergency Telephone System Fund."

Sec. 2. This act becomes effective July 1, 1997.

Explanation - Accounting For 911 Surcharges

Eighty-three counties in North Carolina impose a telephone surcharge on their residents to pay for a 911 Emergency Telephone Service. The General Assembly authorized local governments to establish telephone surcharges in 1989 as a way to pay for emergency telephone systems. Although the statute requires a local government to maintain the surcharge revenues in a separate account, it does not require that the information be included in the annual financial statement. To better enable public examination of this revenue, this proposal specifies that the revenues be placed in a special revenue fund. By definition, budget activity in this type of fund is included in a local government's financial statement.

Upon adoption of a local ordinance, a local government may impose a monthly 911 service charge on each telephone subscriber. The 911 charges are collected by the phone company and remitted to the local government within 10 days after the last day of the month. The phone company retains 1% of the charges collected to compensate it for its administrative expenses. The local government deposits these charges into an Emergency Telephone System Fund. The money in the Fund may be invested, but all earnings remain in the Fund. The money in the Fund may be used only to pay for the lease, purchase, or maintenance of emergency telephone equipment and the rates associated with the service supplier's 911 service.

The 911 surcharges brought counties $19.3 million in fiscal year 1994-95. When legislative fiscal staff examined the financial statements of the 83 counties that impose a 911 surcharge, only 50 counties reported detailed information on the expenditures, revenues, and fund balance of their 911 account. These financial statements disclosed an average fund balance of $237,893. The data is available for every county that imposes the surcharge; the accountant hired by the county only needs to be instructed to include it in the financial statement.

Based on a 1994 survey by the North Carolina chapter of the National Emergency Number Association, 99 counties in the State have a 911 system. The lone county without a system, Greene County, plans to have a system in place by 1997. Approximately half of the counties have an enhanced 911 system that directs calls to the appropriate public safety agencies based on the geographic location of the caller and provides automatic number identification and automatic location of the caller.

Fiscal Report
Fiscal Research Division
December 30, 1996

Proposal 14: Accounting for 911 Surcharges

Summary: Requires local governments to account for 911 surcharges in their annual financial statements.

Effective Date: July 1, 1997

Fiscal Effect:

NO FISCAL IMPACT

The 1989 General Assembly allowed local governments to establish telephone surcharges to pay for emergency telephone systems. Local governments were required to maintain the surcharge revenues in a separate account, but were not required to have information on this account included in the annual financial statement. When legislative fiscal staff examined the financial statements of 83 counties with 911 Emergency Telephone Service, only 50 counties reported detailed information on the expenditures, revenues and fund balance of their 911 account. Since the data is available, the county only needs to instruct the accountant to include it in the financial statement.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S D

Legislative Proposal 15
97-LJX-005(1.4)(Z)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Tax At Rack Improvements. (Public)

Sponsors: Senators Kerr, Cochrane, Cooper, Shaw, and Soles.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO IMPROVE THE ADMINISTRATION OF THE MOTOR FUEL TAX LAWS.

The General Assembly of North Carolina enacts:

Section 1. Part 1 of Article 36C of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-449.62. Nature of tax.**

This Article imposes a tax on motor fuel to provide revenue for the State's transportation needs and for the other purposes listed in Part 7 of this Article. The tax is collected from the supplier or importer of the fuel because this method is the most efficient way to collect the tax. The tax is designed, however, to be paid ultimately by the person who consumes the fuel. The tax becomes a part fo the cost of the fuel and is consequently paid by those who subsequently purchase and consume the fuel."

Section 2. G.S. 105-449.65(a)(5), as repealed by Section 3 of Chapter 647 of the 1995 Session Laws (Reg. Sess. 1996), is reenacted and G.S. 105-449.65, with the reenactment, reads as rewritten:

"**§ 105-449.65. List of persons who must have a license.**

(a) License. -- A person may not engage in business in this State as any of the following unless the person has a license issued by the Secretary authorizing the person to engage in that business:

(1) A refiner.
(2) A supplier.
(3) A terminal operator.
(4) An importer.
(5) An ~~exporter, if the Secretary imposes this requirement by rule.~~ exporter.
(6) A blender.
(7) A motor fuel transporter.
(8) A bulk-end user of undyed diesel fuel.
(9) A retailer of undyed diesel fuel.

(b) Multiple Activity. -- A person who is engaged in more than one activity for which a license is required must have a separate license for each activity, unless this subsection provides otherwise. A person who is licensed as a supplier is not required to obtain a separate license for any other activity for which a license is required and is considered to have a license as a distributor. A person who is licensed as an occasional importer or a tank wagon importer is not required to obtain a separate license as a distributor. A person who is licensed as a distributor is not required to obtain a separate license as an importer if the distributor acquires fuel for import only from an elective supplier or a permissive ~~supplier.~~ supplier and is not required to obtain a separate license as an exporter. A person who is licensed as a distributor or a blender is not required to obtain a separate license as a motor fuel transporter if the distributor or blender does not transport motor fuel for others for hire."

Section 3. G.S. 105-449.66 reads as rewritten:

"**§ 105-449.66. Types of importers; restrictions on who can get a license as an importer.**

(a) Types. -- An applicant for a license as an importer must indicate the type of importer license sought. The types of importers are as follows:

(1) Bonded importer. -- A bonded importer is a person, other than a supplier, who imports, by transport truck or another means of transfer outside the terminal transfer system, motor fuel removed from a terminal located in another state in any of the following circumstances:
a. The state from which the fuel is imported does not require the seller of the fuel to collect motor fuel tax on the removal either at that state's rate or the rate of the destination state.

b. The supplier of the fuel is not an elective supplier.
c. The supplier of the fuel is not a permissive supplier.

(2) Occasional importer. -- An occasional importer is any of the following that imports motor fuel by any means outside the terminal transfer system:
a. A distributor that imports motor fuel on an average basis of no more than once a month during a calendar year.
b. A bulk-end ~~user that is not a distributor.~~ user that acquires motor fuel for import from a bulk plant and is not required to be licensed as a bonded importer.
c. A distributor that imports motor fuel for use in a race car.

(3) Tank wagon importer. -- A tank wagon importer is a person who imports, only by means of a tank wagon, motor fuel that is removed from a terminal or a bulk plant located in another state."

(b) Restrictions. -- A person may not be licensed as more than one type of importer. ~~A person who is a bulk-end user and is not also a distributor may not be licensed as a bonded importer. A person who is a bulk-end user and is not also a distributor may be licensed as an occasional importer with the restriction that the person acquire motor fuel for import only from an elective supplier or a permissive supplier or from a bulk plant.~~ A bulk-end user that imports motor fuel from a terminal of a supplier that is not an elective or a permissive supplier must be licensed as a bonded importer. A bulk-end user that imports motor fuel from a bulk plant and is not required to be licensed as a bonded importer must be licensed as an occasional importer. A bulk-end user that imports motor fuel only from a terminal of an elective or a permissive supplier is not required to be licensed as an importer."

Section 4. G.S. 105-449.67 reads as rewritten:

"**§ 105-449.67. List of persons who may obtain a license.**

~~(a) License. -- A person who is engaged in business as any of the following may obtain a license issued by the Secretary for that business:~~

~~(1) A distributor.~~
~~(2) A permissive supplier.~~
~~(3) An exporter.~~

~~(b) Effect on Exports. -- An exporter license or a distributor license authorizes the license holder to pay the destination state tax on motor fuel purchased for export instead of paying this State's tax on the fuel. An unlicensed exporter or unlicensed distributor must pay this State's tax on motor fuel purchased for export.~~

~~(c) Multiple Activity. -- A person who is licensed as a distributor is considered to have a license as an exporter.~~

A person who is engaged in business as any of the following may obtain a license issued by the Secretary for that business:

(1) A distributor.

(2) A permissive supplier."

Section 5. G.S. 105-449.72 reads as rewritten:

"**§ 105-449.72. Bond or letter of credit required as a condition of obtaining and keeping certain licenses.**

(a) Initial Bond. -- An applicant for a license as a refiner, a terminal operator, a supplier, an importer, ~~an exporter,~~ a blender, a permissive supplier, or a distributor must file with the Secretary a bond or an irrevocable letter of credit. A bond must be conditioned upon compliance with the requirements of this Article, be payable to the State, and be in the form required by the Secretary. The amount of the bond or irrevocable letter of credit is determined as follows:

(1) For an applicant for a license as any of the following, the amount is two million dollars ($2,000,000):
   a. A refiner.
   b. A terminal operator.
   c. A supplier that is a position holder or a person that receives motor fuel pursuant to a two-party exchange.
   d. A bonded importer.
   e. A permissive supplier.

(2) For an applicant for a license as any of the following, the amount is two times the applicant's average expected monthly tax liability under this Article, as determined by the Secretary. The amount may not be less than two thousand dollars ($2,000) and may not be more than two hundred fifty thousand dollars ($250,000):
   a. A supplier that is a fuel alcohol provider but is neither a position holder nor a person that receives motor fuel pursuant to a two-party exchange.

b. An occasional importer.
c. A tank wagon importer.
d. A distributor.
~~e. An exporter.~~

(3) For an applicant for a license as a blender, a bond is required only if the applicant's average expected annual tax liability under this Article, as determined by the Secretary, is at least two thousand dollars ($2,000). When a bond is required, the bond amount is the same as under subdivision (2) of this subsection.

(b) Multiple Activity. -- An applicant for a license as a distributor and as a bonded importer must file only the bond required of a bonded importer. An applicant for two or more of the licenses listed in subdivision (a)(2) or (a)(3) of this section may file one bond that covers the combined liabilities of the applicant under all the activities. A bond for these combined activities may not exceed the maximum amount set in subdivision (a)(2) of this subsection.

(c) Adjustment to Bond. -- When notified to do so by the Secretary, a person that has filed a bond or an irrevocable letter of credit and that holds a license listed in subdivision (a)(2) of this section must file an additional bond or irrevocable letter of credit in the amount requested by the Secretary. The person must file the additional bond or irrevocable letter of credit within 30 days after receiving the notice from the Secretary. The amount of the initial bond or irrevocable letter of credit and any additional bond or irrevocable letter of credit filed by the license holder, however, may not exceed the limits set in subdivision (a)(2) of this section."

Section 6. G.S. 105-449.77(b) reads as rewritten:

"(b) Supplier Lists. -- The Secretary must give a list of licensed suppliers, licensed terminal operators, licensed importers, licensed distributors, and licensed exporters to each licensed supplier. The list must state the name, account number, and business address of each license holder on the list. The Secretary must send a monthly update of the list to each licensed supplier.

The Secretary must give a list of licensed suppliers to each licensed distributor, licensed exporter, and licensed importer. The Secretary must also give a list of licensed suppliers to each unlicensed distributor ~~or unlicensed exporter~~ that asks for a copy of the list. The list must state the name, account number,

and business address of each supplier on the list and must indicate whether the supplier is an elective supplier, a permissive supplier, or an in-State-only supplier. The Secretary must send an annual update of the list to each licensed distributor, licensed exporter, and licensed importer, and to each unlicensed distributor ~~or unlicensed exporter~~ that requested a copy of the list."

Section 7. G.S. 105-449.82(c) reads as rewritten:

(c) Terminal Rack Removal. -- The excise tax imposed by G.S. 105-449.81(1) on motor fuel removed at a terminal rack in this State is payable by the person that first receives the fuel upon its removal from the terminal. If the motor fuel is removed by an unlicensed distributor, the supplier of the fuel is jointly and severally liable for the tax due on the fuel. If the motor fuel is sold by a person who is not licensed as a supplier, as required by this Article, the terminal operator, the person selling the fuel, and the person removing the fuel are jointly and severally liable for the tax due on the fuel. If the motor fuel removed is not dyed diesel fuel but the shipping document issued for the fuel states that the fuel is dyed diesel fuel, the terminal operator, the supplier, and the person removing the fuel are jointly and severally liable for the tax due on the fuel.

If the motor fuel is removed for export by an unlicensed exporter, the exporter is liable for tax on the fuel at the motor fuel rate and at the rate of the destination state. The liability for the tax at the motor fuel rate applies when the Department assesses the unlicensed exporter for the tax.

Section 8. G.S. 105-449.87(c) reads as rewritten:

"(c) Imputed Knowledge. -- ~~An end seller of dyed diesel fuel is considered to have known or had reason to know that the fuel would be used for a purpose that is taxable under this section unless the end seller delivered the fuel into a storage facility that meets one of the following requirements:~~

~~(1) It contains fuel used only in heating, drying crops, or a manufacturing process and is installed in a manner that makes use of the fuel for any other purpose improbable.~~

~~(2) It is marked as follows with the phrase "Dyed Diesel", "For Nonhighway Use", or a similar phrase that clearly indicates the fuel is not to be used to operate a highway vehicle:~~

~~a. The storage tank of the storage facility is marked if the storage tank is visible.~~

~~b. The fillcap or spill containment box of the storage facility is marked.~~

~~c. The dispensing device that serves the storage facility is marked.~~

An end seller of dyed diesel fuel is considered to have known or had reason to know that the fuel would be used for a purpose that is taxable under this section if the end seller delivered the fuel into a storage facility that was not marked as required by G.S. 105-449.123."

Section 9. Part 3 of Article 36C of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-449.88A. Liability for tax due on motor fuel designated as exempt by the use of cards or codes.**

(a) Exempt Cards At Rack. -- When a licensed distributor or licensed importer removes motor fuel from a terminal by means of an exempt card or exempt access code issued by the supplier, the distributor or importer represents that the fuel removed will be resold to a governmental unit that is exempt from the tax. A supplier may rely on this representation. A licensed distributor or licensed importer that does not resell motor fuel removed from a terminal by means of an exempt card or exempt access code to an exempt governmental unit is liable for any tax due on the fuel.

(b) Exempt Cards At Retail. -- A supplier that issues to, or authorizes another person to issue to, another person a credit card or an access code that enables the person to buy motor fuel at retail without paying the tax on the fuel has a duty to determine if the person is exempt from the tax. A supplier is liable for tax due on motor fuel purchased at retail by use of a credit card or an access code issued to a person who is not exempt from the tax.

(c) Card Holder. -- A person to whom an exempt card or exempt access card is issued for use at a terminal or at retail is liable for any tax due on fuel purchased with the card for a purpose that is not exempt. A person who misuses an exempt card or code by purchasing fuel with the card or code for a purpose that is not exempt is liable for the tax due on the fuel."

Section 10. G.S. 105-449.89 reads as rewritten:

"**§ 105-449.89. Removals by out-of-state bulk-end user.**

~~An out-of-state bulk-end user may remove motor fuel from a terminal in this State for use in the state in which the bulk-end user is located as follows:~~

~~(1) Upon payment to the supplier of tax on the motor fuel at the motor fuel rate.~~

~~(2) Upon payment to the supplier of destination, state tax on the motor fuel, if the bulk-end user acquires the fuel from a supplier who, with respect to the destination state of the fuel, is either a permissive supplier or an elective supplier and therefore collects the destination state tax on the fuel.~~

An out-of-state bulk-end user may not remove motor fuel from a terminal in this State for use in the state in which the bulk-end user is located unless the bulk-end user is licensed under this Article as an exporter. An out-of-state bulk-end user that is not licensed under this Article may remove motor fuel from a bulk plant in this State."

Section 11. G.S. 105-449.90 reads as rewritten:

"**§ 105-449.90. When tax return and payment are due.**

(a) Filing Periods. -- The excise tax imposed by this Article is payable when a return is due. A return is due annually, quarterly, or monthly, as specified in this section. A return must be filed with the Secretary and be in the form required by the Secretary.

An annual return is due within 45 days after the end of each calendar year. An annual return covers tax liabilities that accrue in the calendar year preceding the date the return is due.

A quarterly return is due by the last day of the month that follows the end of a calendar quarter. A quarterly return covers tax liabilities that accrue in the calendar quarter preceding the date the return is due.

A monthly return of a person other than an occasional importer is due within 22 days after the end of each month. A monthly return of an occasional importer is due by the ~~1st~~ 3rd of each month. A monthly return covers tax liabilities that accrue in the calendar month preceding the date the return is due."

(b) Annual Filers. -- A terminal operator must file an annual return for the compensating tax imposed by G.S. 105-449.85.

(c) Quarterly Filers. -- A licensed importer that removes fuel at a terminal rack of a permissive or an elective supplier and a licensed distributor must file a quarterly return under G.S. 105-449.94 to reconcile exempt sales.

(d) Monthly Filers on 22nd. -- The following persons must file a monthly return by the 22nd of each month:

(1) A refiner.
(2) A supplier.
(3) A bonded importer.
(4) A blender.

(5) A tank wagon importer.
(6) A person that incurred a liability under G.S. 105-449.86 during the preceding month for the tax on dyed diesel fuel used to operate certain highway vehicles.
(7) A person that incurred a liability under G.S. 105-449.87 during the preceding month for the backup tax on motor fuel.

(e) Monthly Filers on ~~1st.~~ 3rd. -- An occasional importer must file a monthly return by the ~~1st~~ third day of each month. An occasional importer is not required to file a return, however, if all the motor fuel imported by the importer in a reporting period was removed at a terminal located in another state and the supplier of the fuel is an elective supplier or a permissive supplier."

Section 12. G.S. 105-449.91 reads as rewritten:

"**§ 105-449.91. Remittance of tax to supplier.**

(a) Distributor. -- A distributor must remit tax due on motor fuel removed at a terminal rack to the supplier of the fuel. A licensed distributor has the right to defer the remittance of tax to the supplier, as trustee, until the date the trustee must pay the tax to this State or to another state. The time when an unlicensed distributor must remit tax to a supplier is governed by the terms of the contract between the supplier and the unlicensed distributor.

(b) Exporter. -- An exporter must remit tax due on motor fuel removed at a terminal rack to the supplier of the fuel. ~~A licensed exporter that is also licensed in the destination state has the right to defer the remittance of tax to the supplier until the date set by the law of the destination state of the fuel. The time when an unlicensed exporter, or a licensed exporter that is not also licensed in the destination state, must remit tax to a supplier is governed by the terms of the contract between the supplier and the exporter.~~ The time when an exporter must remit tax to a supplier is governed by the law of the destination state of the exported motor fuel."

(c) Importer. -- A licensed importer must remit tax due on motor fuel removed at a terminal rack of a permissive or an elective supplier to the supplier of the fuel. A licensed importer that removes fuel from a terminal rack of a permissive or an elective supplier has the right to defer the remittance of tax to the supplier until the date the supplier must pay the tax to this State.

(d) General. -- The method by which a distributor, ~~an~~ a licensed exporter, or a licensed importer must remit tax to a supplier is governed by the terms of the contract between the supplier and the distributor, exporter, or licensed importer and the supplier. G.S. 105-449.76 governs the cancellation of a license of a distributor, an exporter, and an importer."

Section 13. G.S. 105-449.92(b) reads as rewritten:

"(b) Effect of Notice. -- A supplier that sells motor fuel to a distributor ~~or an exporter~~ after receiving notice from the Secretary that the Secretary has cancelled the distributor's ~~or exporter's~~ license is jointly and severally liable with the distributor ~~or exporter~~ for any tax due on motor fuel the supplier sells to the distributor ~~or exporter~~ after receiving the notice. This joint and several liability does not apply to excise tax due on motor fuel sold to a previously unlicensed distributor ~~or unlicensed exporter~~ after the supplier receives notice from the Secretary that the Secretary has issued another license to the ~~distributor or exporter.~~ distributor."

Section 14. G.S. 105-449.96 reads as rewritten:

"**§ 105-449.96. Information required on return filed by supplier.**

A return of a supplier must list all of the following information and any other information required by the Secretary:

(1) The number of gallons of tax-paid motor fuel received by the supplier during the month, sorted by type of fuel, seller, point of origin, destination state, and carrier.

(2) The number of gallons of motor fuel removed at a terminal rack during the month from the account of the supplier, sorted by type of fuel, person receiving ~~distributor, exporter, or importer,~~ the fuel, terminal code, and carrier.

(3) The number of gallons of motor fuel removed during the month for export, sorted by type of fuel, person receiving ~~distributor or exporter,~~ the fuel, terminal code, destination state, and carrier.

(4) The number of gallons of motor fuel removed during the month at a terminal located in another state for destination to this State, as indicated on the shipping document for the fuel, sorted by type of fuel, person receiving ~~distributor, exporter, or importer,~~ the fuel, terminal code, and carrier.

(5) The number of gallons of motor fuel the supplier sold during the month to any of the following, sorted by type of fuel, exempt entity, person

receiving ~~distributor,~~ the fuel, terminal code, and carrier:

a. A governmental unit whose use of fuel is exempt from the tax.

b. A licensed distributor or importer that resold the motor fuel to a governmental unit whose use of fuel is exempt from the tax, as indicated by the ~~distributor.~~ distributor or importer.

c. A licensed exporter that resold the motor fuel to a person whose use of fuel is exempt from tax in the destination state, as indicated by the exporter.

(6) The amount of discounts allowed under G.S. 105-449.93(b) on motor fuel sold during the month to licensed distributors or licensed importers."

Section 15. G.S. 105-449.97 reads as rewritten:

"**§ 105-449.97. Deductions and discounts allowed a supplier when filing a return.**

(a) Taxes Not Remitted. -- When a supplier files a return, the supplier may deduct from the amount of tax payable with the return the amount of tax any of the following license holders owes the supplier but failed to remit to the supplier:

(1) A licensed distributor.

(2) A licensed importer that removed the motor fuel on which the tax is due from a terminal of an elective or a permissive supplier.

(3) Repealed by Session Laws 1995, c. 647, s. 32.

A supplier is not liable for tax a license holder listed in this subsection owes the supplier but fails to pay. If a listed license holder pays tax owed to a supplier after the supplier deducts the amount on a return, the supplier must promptly remit the payment to the Secretary.

(b) Administrative Discount. -- A supplier that files a timely return may deduct from the amount of tax payable with the return an administrative discount of one-tenth of one percent (0.1%) of the amount of tax payable to this State as the trustee, not to exceed eight thousand dollars ($8,000) a month. The discount covers expenses incurred in collecting taxes on motor fuel.

(c) Percentage Discount. -- A supplier that sells motor fuel directly to an unlicensed distributor ~~or unlicensed exporter~~ or to the bulk-end user, the retailer, or user of the fuel may take the same percentage discount on the fuel that a licensed

distributor may take under G.S. 105-449.93(b) when making deferred payments of tax to the supplier.

(d) Taxes Paid On Exempt Retail Sales. -- When filing a return, a supplier that issues or authorizes the issuance of an exempt card or an exempt access code to a person that enables the person to buy motor fuel at retail without paying tax on the fuel may deduct the amount of excise tax imposed on fuel purchased with the exempt retail card or code. The amount of excise tax imposed on fuel purchased at retail with an exempt retail card or code is the amount that was imposed on the fuel when it was delivered to the retailer of the fuel."

Section 16. G.S. 105-449.98 reads as rewritten:

"**§ 105-449.98. Duties of supplier concerning payments by distributors, exporters, and importers.**

(a) As Fiduciary. -- A supplier has a fiduciary duty to remit to the Secretary the amount of tax paid to the supplier by a licensed distributor, licensed exporter, or licensed importer. A supplier is liable for taxes paid to the supplier by a licensed distributor, licensed exporter, or licensed importer.

(b) ~~Notification to Distributor or Exporter.~~ Notice of Fuel Received. -- A supplier must notify a licensed ~~distributor or licensed exporter~~ distributor, a licensed exporter, or a licensed importer that received motor fuel from the supplier during a reporting period of the number of taxable gallons received. The supplier must give this notice after the end of each reporting period and before the ~~licensed distributor or licensed exporter~~ license holder must remit to the supplier the amount of tax due on the fuel.

(c) ~~Notification~~ Notice to Department. -- A supplier of motor fuel at a terminal must notify the Department within 10 business days after a return is due of any licensed ~~distributors or licensed exporters~~ distributors, licensed exporters, or licensed importers that did not pay the tax due the supplier when the supplier filed the return. The ~~notification~~ notice must be transmitted to the Department in the form required by the Department.

(d) Payment Application. -- A supplier that receives a payment of tax from a ~~distributor or a licensed exporter~~ licensed distributor, a licensed exporter, or a licensed importer may not apply the payment to ~~debts~~ a debt that person owes the supplier for motor fuel purchased from the supplier."

Section 17. G.S. 105-449.105(a) reads as rewritten:

"(a) Exempt Fuel. -- A ~~distributor~~ person may obtain a refund of tax paid by the ~~distributor~~ person on motor fuel sold to a

governmental unit whose use of motor fuel is exempt from the motor fuel excise tax. A governmental unit whose use of motor fuel is exempt from the motor fuel excise tax may obtain a refund of tax paid by it on motor fuel. A person may obtain a refund of tax paid by the person on exported fuel, including fuel whose shipping document shows this State as the destination state but was diverted to another state in accordance with the diversion procedures established by the Secretary."

Section 18. G.S. 105-449.116 reads as rewritten:

"**§ 105-449.116. Import confirmation number required for some imported motor fuel.**

(a) Requirement. -- A bonded importer or an occasional importer that acquires motor fuel for import by transport truck from a supplier that is not an elective supplier or a permissive supplier, and therefore will not be acting as trustee for the remittance of tax to the State on behalf of the importer, must obtain an import confirmation number from the Secretary before importing the motor fuel. The importer must write the import confirmation number on the shipping document issued for the fuel. The importer must obtain a separate import confirmation number for each transport truck delivery of motor fuel into this State.

(b) Penalty. -- An importer that does not obtain an import confirmation number when required by this section is liable for a civil penalty. The civil penalty is payable to the Department of Transportation, Division of Motor Vehicles, or the Department of Revenue and is payable by the person in whose name the transport truck is registered. The amount of the penalty depends on whether the person against whom the penalty is assessed has previously been assessed a penalty under this subsection. For a first assessment under this subsection, the penalty is the same as the amount for a first assessment under G.S. 105-449.115(f). For a second or subsequent assessment under this subsection, the penalty is the same as the amount for a second or subsequent assessment under G.S. 105-449.115(f). A penalty imposed under this subsection is in addition to any motor fuel tax assessed."

Section 19. G.S. 105-449.117 reads as rewritten:

"**§ 105-449.117. Penalties for highway use of dyed diesel or other non-tax-paid fuel.**

It is unlawful to use dyed diesel fuel ~~for a highway use~~ in a highway vehicle that is licensed or required to be licensed under Chapter 20 of the General Statutes unless that use is ~~permitted~~ allowed under section 4082 of the Code. It is unlawful to use undyed diesel fuel in a highway vehicle that is licensed or required to be licensed under Chapter 20 of the General Statutes

unless the tax imposed by this Article has been paid. A person who ~~operates on a highway a highway vehicle whose supply tank contains dyed diesel fuel whose use is unlawful under this section or contains other fuel on which the tax imposed by this Article has not been paid~~ violates this section is guilty of a Class 1 misdemeanor and is liable for a civil penalty.

The civil penalty is payable to the Department of Transportation, Division of Motor Vehicles, or the Department of Revenue and is payable by the person in whose name the highway vehicle is registered. The amount of the penalty depends on the amount of fuel in the supply tank of the highway vehicle. The penalty is the greater of one thousand dollars ($1,000) or five times the amount of motor fuel tax payable on the fuel in the supply tank. A penalty imposed under this section is in addition to any motor fuel tax assessed."

Section 20. G.S. 105-449.120(a)(3) reads as rewritten:

"(3) Willfully fails to pay a tax when due under this ~~Article.~~ Article or under former Article 36 or 36A of this Chapter. Failure to comply with a requirement of a supplier to remit tax payable to the supplier by electronic funds transfer is considered a failure to make a timely payment."

Section 21. The catchline to G.S. 105-449.122 reads as rewritten:

"**§ 105-449.122. ~~Miscellaneous~~ Equipment requirements.**"

Section 22. Part 6 of Article 36C of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-449.123. Marking requirements for dyed diesel fuel storage facilities.**

(a) Requirements. -- A person who is a retailer of dyed diesel fuel or who stores both dyed and undyed diesel fuel for use by that person or another person must mark the storage facility for the dyed diesel fuel as follows with the phrase 'Dyed Diesel', 'For Nonhighway Use', or a similar phrase that clearly indicates the diesel fuel is not to be used to operate a highway vehicle:

(1) The storage tank of the storage facility must be marked if the storage tank is visible.

(2) The fillcap or spill containment box of the storage facility must be marked.

(3) The dispensing device that serves the storage facility must be marked.

(b) Exception. -- The marking requirements of this section do not apply to a storage facility that contains fuel used only in heating, drying crops, or a manufacturing process and is

installed in a manner that makes use of the fuel for any other purpose improbable."

Section 23. G.S. 105-449.133 reads as rewritten:

"**§ 105-449.133. Bond or letter of credit required as a condition of obtaining and keeping ~~license as alternative fuel provider.~~ certain licenses.**

(a) Who Must Have Bond. -- ~~An applicant~~ The following applicants for a license ~~as an alternative fuel provider~~ must file with the Secretary a bond or an irrevocable letter of ~~credit in an~~ credit:

(1) An alternative fuel provider.

(2) A retailer or a bulk-end user that intends to store highway and nonhighway alternative fuel in the same storage facility.

(b) Amount. -- The amount of the bond is the amount that would be required if the fuel the applicant intended to provide or store was motor fuel rather than alternative fuel. An applicant that is also required to file a bond or an irrevocable letter of credit under G.S. 105-449.72 to obtain a license as a distributor of motor fuel may file a single bond or irrevocable letter of credit under that section for the combined amount.

A bond filed under this subsection must be conditioned upon compliance with this Article, be payable to the State, and be in the form required by the Secretary. The Secretary may require a bond issued under this subsection to be adjusted in accordance with the procedure set out in G.S. 105-449.72 for adjusting a bond filed by a distributor of motor fuel."

Section 24. G.S. 105-449.137(a) reads as rewritten:

"(a) Liability. -- A bulk-end user or retailer that stores highway and nonhighway alternative fuel in the same storage facility is liable for the tax imposed by this Article. The tax payable by a bulk-end user or retailer applies when fuel is withdrawn from the storage facility. The alternative fuel provider that sells or delivers alternative fuel is liable for the tax imposed by this ~~Article.~~ Article on all other alternative fuel."

Section 25. G.S. 105-449.138 reads as rewritten:

"**§ 105-449.138. Requirements for bulk-end users and retailers.**

(a) Informational Return. -- A bulk-end user and a retailer must file a quarterly informational return with the Secretary. A quarterly return covers a calendar quarter and is due by the last day of the month that follows the quarter covered by the return.

The return must give the following information and any other information required by the Secretary:

(1) The amount of alternative fuel received during the quarter.

(2) The amount of alternative fuel sold or used during the quarter.

(b) Storage. -- ~~A storage facility used by a bulk-end user or a retailer must be marked in a manner similar to that required for diesel fuel by G.S. 105-449.87(c) if the alternative fuel stored in the facility is to be used for a purpose other than to operate a highway vehicle.~~ A bulk-end user or a retailer may store highway and nonhighway alternative fuel in separate storage facilities or in the same storage facility. If highway and nonhighway alternative fuel are stored in separate storage facilities, the facility for the nonhighway fuel must be marked in accordance with the requirements set by G.S. 105-449.123 for dyed diesel storage facilities. If highway and nonhighway alternative fuel are stored in the same storage facility, the storage facility must be equipped with separate metering devices for the highway fuel and the nonhighway fuel. If the Secretary determines that a bulk-end user or retailer used or sold alternative fuel to operate a highway vehicle when the fuel was dispensed from a storage facility or through a meter marked for nonhighway use, all fuel delivered into that storage facility is presumed to have been used to operate a highway vehicle."

Section 26. Sections 1, 19, and 20 of this act are effective when this act becomes law. The remaining sections of this act become effective October 1, 1997.

Explanation of Legislative Proposal 15 (97-LJX-005)
Tax at Rack Improvements

This bill makes changes to the method of collecting motor fuel taxes commonly referred to as "tax at the rack." The State adopted this method effective January 1, 1996. The method bears this name because it imposes the per gallon excise tax when motor fuel is put into a truck by means of a "rack" at a pipeline terminal.

The bill changes the licensing requirements for exporters and makes several clarifying changes as described below. The General Statute sections affected are arranged in numerical order in the bill for ease of location.

Section 1: Ensures that the State's gas tax will be considered a "pass-through" tax if challenged under the same principles as the United States Supreme Court decision in the Chickasaw case. In that case, the Oklahoma gas tax was held to not apply to native american sellers because the tax was not a pass-through tax.

Sections 2 and 4: Require exporters to be licensed. Under current law, an exporter can be but is not required to be licensed. A licensed exporter pays tax at the destination state rate, however, and an unlicensed exporter must pay tax at the North Carolina rate. This difference in treatment results in the unlicensed exporter paying both the North Carolina tax and the tax of the destination state and then having to apply to North Carolina for a refund. The proposed requirement that all exporters be licensed parallels the current requirement that all importers be licensed.

Section 3: Changes the importer licensing provisions for a bulk-end user, such as a trucking company. The section:

(1) Allows bulk-end users to be bonded importers and thereby buy fuel at an out-of-state terminal that does not precollect the North Carolina motor fuel tax, Current law prohibits a bulk-end user from obtaining a bonded importer license.

(2) Relieves bulk-end users of the importer licensing requirement if they buy all their imported fuel at an out-of-state terminal that precollects the North Carolina tax. Current law requires an occasional importer license in this circumstance. This proposed change parallels the current treatment of distributors; a distributor that imports only from a terminal that precollects the North Carolina tax is not required to have an importer license.

Section 5: Deletes the requirement that an exporter file a bond. This change is made because the bill now requires all exporters to be licensed. The purpose of licensing is primarily to track cross-border shipments of fuel and the bonding requirement is not necessary for this purpose. Current law

requires an exporter that chooses to be licensed to pay a bond based on expected tax liability, but at least $2,000 and no more than $250,000.

Section 6: Deletes references to unlicensed exporters. Sections 2 and 4 of the bill require all exporters to be licensed, so there will no longer be unlicensed exporters.

Section 7: Imposes potential liability on an unlicensed exporter for North Carolina tax on the fuel exported. The bill requires exporters to be licensed so they should not buy without a license. If they do buy without a license, the Department can assess tax on the fuel purchased at the North Carolina rate.

Sections 8 and 22: Reduce the marking requirements for dyed diesel storage tanks by requiring a tank to be marked only if the tank is at retail location or at the location of a user that stores both dyed and undyed diesel. Current law requires all dyed diesel storage tanks to be labeled "For Nonhighway Use" unless the fuel in the tank is for home heating, drying crops, or manufacturing.

Section 9: Clarifies the tax liability concerning the use of exempt cards and exempt access codes. The section provides that a supplier is not liable for any tax due on fuel sold to a distributor who represented that the fuel would be resold to an exempt governmental entity but who did not resell the fuel to a tax-exempt entity. Distributors make this representation by using a card or access code issued by the supplier when getting the fuel at the terminal that allows the distributor to buy the fuel tax-free. If a distributor in this circumstance sells tax-free fuel to a person who is not exempt, the distributor is liable for any tax due on the fuel.

The section also makes it clear that a supplier that issues a card or code that enables a person to buy fuel at retail without being charged the tax already paid on the fuel has a duty to determine if the person is actually tax-exempt. A supplier is responsible for any tax due if the person to whom the supplier issued the card is not an exempt entity.

Section 10: Requires an out-of-state bulk end user that buys fuel at a North Carolina terminal, as opposed to a bulk plant, to be licensed as a distributor or exporter. This change accompanies the change made by Sections 2 and 4 of this bill that require all exporters to be licensed. Unless the bulk-end user falls within the grandfather group of users that can get distributor licenses, the user will need to be licensed as an exporter.

Section 11: Changes the due date of a return of an occasional importer from the first of each month to the third of each month. This change is made at the request of sellers of racing gasoline who pointed out that if they buy fuel on

the last day of a month it is difficult to prepare the return and send it in the next day.

Section 12: Deletes references to unlicensed exporters.

Section 13: Deletes references to an exporter.

Section 14: Adds imports to the categories of information contained on a supplier's return. It does this by replacing references to specific license holders in some places with the generic reference to "person receiving the fuel" and by adding references to "importer" in others.

Section 15: Allows a supplier to take a deduction on the supplier's return for taxes paid by the supplier on fuel that was subsequently sold at retail to a person who is exempt from tax and who used a card issued by the supplier to indicate their tax-exempt status when buying the fuel.

Section 16: Adds importers to the groups of license holders that must receive certain information from suppliers and about whom the suppliers must notify the Department.

Section 17: Clarifies that anyone who pays tax on fuel that is exempt from tax can apply for a refund of the tax paid.

Section 18: Adds a civil penalty for failure to get an importer confirmation number. Current law contains no penalty. The proposed penalty is the same as the penalty for failure to obtain a diversion number to take fuel to a state other than the one listed on the fuel's shipping document as the destination state of the fuel.

Section 19: Clarifies that the penalty for using dyed diesel or other non-tax-paid fuel in a highway vehicle applies to all fuel used in the vehicle. Current law applies the penalty to fuel used "for a highway use." This language can be construed to mean that a vehicle that is parked at a rest area or the parking lot of company and that has dyed diesel in its tanks is not subject to the penalty because the fuel is not at that moment being used for a highway use.

Section 20: Clarifies that failure to pay a tax under the former motor fuel tax laws is to be treated the same as a failure to pay under the revised laws. When tax at the rack was implemented, the existing motor fuel tax laws were repealed and replaced by the new provisions. Many assessments for taxes owed under the former laws have not been paid.

Section 21: Makes a technical change to accommodate the addition of a new statute in Section 20 to come after G.S. 105-449.122. Statutes with headings of miscellaneous requirements are typically the last statute in a Part or Article and this statute will no longer be the last one.

Section 23: Requires a retailer or bulk user of alternative fuel that will be the taxpayer for the fuel to post a bond.

Section 24: Changes when the liability for tax on certain alternative fuel accrues. The section allows those retailers and users that use the same storage tank for highway and nonhighway alternative fuel to pay tax on the highway alternative fuel when it is metered from the tank. Current law requires taxes on alternative fuel to be paid when the fuel is delivered to the retailer of the fuel or the bulk user of the fuel. For alternative fuel used for a dual purpose, the provider of the fuel does not know how much fuel will be used for a highway purpose when the fuel is delivered to the retailer or user.

Section 25: Allows retailers and bulk-end users of alternative fuel to store the fuel in a tank that holds both highway and nonhighway alternative fuel if the tank has separate metering devices to measure fuel that is used for a highway use and fuel that is used for some other purpose.

Section 26: Makes all sections of the act except three clarifying changes effective October 1, 1997. The three clarifying sections are effective when the act becomes law.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S **D**

Legislative Proposal 16
97-LCX-001(1.1)(Z)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Revenue Laws Technical Changes. (Public)

Sponsors: Senators Cochrane, Cooper, Kerr, Shaw and Soles.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 14-407 is repealed.

Section 2. Effective January 1, 1997, G.S. 105-23(b) reads as rewritten:

"(b) Exception. -- An inheritance tax return is not required to be filed for an estate that meets all of the following conditions:

(1) Its beneficiaries are all either Class A beneficiaries, as described in G.S. 105-4(a), or the surviving spouse.

(2) Its gross value, including the value of transfers over which the decedent retained an interest and the value of gifts made within three years before the decedent's death, as provided in G.S. 105-2(a)(3), is less than ~~four hundred fifty thousand dollars ($450,000).~~ six hundred thousand dollars ($600,000)."

Section 3. G.S. 105-130.22 reads as rewritten:

"**§ 105-130.22. Tax credit for construction of dwelling units for handicapped persons.**

There ~~shall be~~ is allowed to corporate owners of multifamily rental units located in ~~North Carolina~~ this State as a credit against the tax imposed by this Division, an amount equal to five hundred fifty dollars ($550.00) for each dwelling unit constructed by ~~such corporate owner which~~ the corporate owner that comforms to ~~the requirements of section (11x)~~ Volume I-C of the North Carolina Building Code for the taxable year within which the construction of ~~such~~ the dwelling unit is ~~completed; provided, that credit will be allowed under this section only for the number of such~~ completed. The credit is allowed only for dwelling units completed during the taxable year ~~which~~ that were required to be built in compliance with ~~section (11x)~~ Volume I-C of the North Carolina Building ~~Code; provided further, that if~~ Code. If the credit allowed by this section exceeds the tax imposed by this Division reduced by all other credits ~~allowed by the provisions of this Division, such excess shall be allowed against the tax imposed by this Division~~ allowed, the excess may be carried forward for the next succeeding ~~year; and provided further, that in~~ year. In order to secure the credit allowed by this section the corporation shall file with its income tax return ~~for the taxable year with respect to which such credit is to be claimed,~~ a copy of the occupancy permit on the face of which ~~there shall be~~ is recorded by the building inspector the number of units completed during the taxable year ~~which conform to section (11x)~~ that conform to Volume I-C of the North Carolina Building Code. ~~When he has recorded~~ After recording the number of ~~such~~ these units on the face of the occupancy permit, the building inspector shall promptly ~~make and~~ forward a copy of the permit to the ~~Special Office for the Handicapped,~~ Building Accessibilty Section of the Department of Insurance."

Section 4. G.S. 150-151.1 reads as rewritten:

"**§ 105-151.1. Tax credit for construction of dwelling units for handicapped persons.**

There ~~shall be~~ is allowed to resident owners of multifamily rental units located in ~~North Carolina~~ this State as a credit against the tax imposed by this Division an amount equal to five hundred fifty dollars ($550.00) for each dwelling unit constructed by the resident owner that conforms to Volume I-C of the North Carolina Building Code for the taxable year within which the construction of the dwelling unit is completed. The credit is allowed only for dwelling units completed during the taxable year that were required to be built in compliance with Volume I-C of the North Carolina Building Code. If the credit allowed by this section exceeds the tax imposed by this Division

reduced by all other credits allowed, the excess may be carried forward for the next succeeding year. In order to claim the credit allowed by this section, the taxpayer shall file with its income tax return a copy of the occupancy permit on the face of which is recorded by the building inspector the number of units completed during the taxable year that conform to Volume I-C of the North Carolina Building Code. After recording the number of these units on the face of the occupancy permit, the building inspector shall promptly forward a copy of the permit to the Building Accessibility Section of the Department of Insurance.

~~to the recommendations of section (11x) of the North Carolina Building Code for the taxable year within which the construction of the dwelling units is completed; provided, that credit will be allowed under this section only for the number of dwelling units completed during the taxable year that were required to be built in compliance with section (11x) of the North Carolina Building Code; provided further, that if the credit allowed by this section exceeds the tax imposed by this Division reduced by all other credits allowed by this Division, the excess shall be allowed as a credit against the tax imposed by this Division for the next succeeding year; and provided further, that in order to secure the credit allowed by this section the taxpayer shall file with the income tax return for the taxable year with respect to which the credit is to be claimed, a copy of the occupancy permit on the face of which there shall be recorded by the building inspector the number of units completed during the taxable year that conform to section (11x) of the North Carolina Building Code. After recording the number of units on the face of the occupancy permit, the building inspector shall promptly forward a copy of the permit to the Special Office for the Handicapped, Department of Insurance.~~"

Section 5. G.S. 105-163.010 reads as rewritten:

"**§ 105-163.010. (Repealed effective for investments made on or after January 1, 1999) Definitions.**

The following definitions apply in this Division:

~~(1) Affiliate. -- An individual or business that controls, is controlled by, or is under common control with another individual or business.~~

~~(2) Business. -- A corporation, partnership, association, or sole proprietorship operated for profit.~~

~~(3) Control. -- A person controls an entity if the person owns, directly or indirectly, more than ten percent (10%) of the voting securities of that~~

~~entity. As used in this subdivision, the term 'voting security' means a security that (i) confers upon the holder the right to vote for the election of members of the board of directors or similar governing body of the business or (ii) is convertible into, or entitles the holder to receive upon its exercise, a security that confers such a right to vote. A general partnership interest is a voting security.~~

~~(4) Equity security. -- Common stock, preferred stock, or an interest in a partnership, or subordinated debt that is convertible into, or entitles the holder to receive upon its exercise, common stock, preferred stock, or an interest in a partnership.~~

~~(5) Financial institution. -- A business that is (i) a bank holding company, as defined in the Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841 et seq., or its wholly-owned subsidiary, (ii) registered as a broker-dealer under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq., or its wholly-owned subsidiary, (iii) an investment company as defined in the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq., whether or not it is required to register under that act, (iv) a small business investment company as defined in the Small Business Investment Act of 1958, 15 U.S.C. §§ 661 et seq., (v) a pension or profit-sharing fund or trust, or (vi) a bank, savings institution, trust company, financial services company, or insurance company; provided, however, that a business, other than a small business investment company, is not a financial institution if its net worth, when added to the net worth of all of its affiliates, is less than ten million dollars ($10,000,000); provided further, however, that a business is not a financial institution if it does not generally market its services to the public and it is controlled by a business that is not a financial institution.~~

~~(6) Repealed by Session Laws 1991, c. 637.~~

~~(6a) North Carolina Enterprise Corporation. -- A corporation established in accordance with Article 3 of Chapter 53A of the General Statutes or a~~

~~limited partnership in which a North Carolina Enterprise Corporation is the only general partner.~~

~~(6b) Pass-through entity. -- An entity or business, including a limited partnership, a general partnership, a joint venture, a Subchapter S Corporation, or a limited liability company, all of which is treated as owned by individuals or other entities under the federal tax laws, in which the owners report their share of the income, losses, and credits from the entity or business on their income tax returns filed with this State. For the purpose of this Division, an owner of a pass-through entity is an individual or entity who is treated as an owner under the federal tax laws.~~

~~(7) Qualified business venture. -- A business that (i) engages primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry, and (ii) is registered with the Secretary of State under G.S. 105-163.013.~~

~~(8) Qualified grantee business. -- A business that (i) has received during the preceding three years a grant or other funding from the North Carolina Technological Development Authority, the North Carolina Technological Development Authority, Inc., North Carolina First Flight, Inc., the North Carolina Biotechnology Center, the Microelectronics Center of North Carolina, the Kenan Institute for Engineering, Technology and Science, or the Federal Small Business Innovation Research Program, and (ii) is registered with the Secretary of State under G.S. 105-163.013.~~

~~(9) Repealed by Session Laws 1993, c. 443, s. 1.~~

~~(9a) Real estate-related business. -- A business that is involved in or related to the brokerage, selling, purchasing, leasing, operating, or managing of hotels, motels, nursing homes or other lodging facilities, golf courses, sports or social clubs, restaurants, storage facilities, or commercial or residential lots or buildings is a real estate-related business, except that a real estate-related business does not include (i) a business that purchases or leases real estate from others for the purpose of providing itself with~~

~~facilities from which to conduct a business that is not itself a real estate-related business or (ii) a business that is not otherwise a real estate-related business but that leases, subleases, or otherwise provides to one or more other persons a number of square feet of space which in the aggregate does not exceed fifty percent (50%) of the number of square feet of space occupied by the business for its other activities.~~

~~(9b) Selling or leasing at retail. -- A business is selling or leasing at retail if the business either (i) sells or leases any product or service of any nature from a store or other location open to the public generally or (ii) sells or leases products or services of any nature by means other than to or through one or more other businesses.~~

~~(9c) Service-related industry. -- A business is engaged in a service-related industry, whether or not it also sells a product, if it provides services to customers or clients and does not as a substantial part of its business engage in a business described in G.S. 105-163.013(b)(4). A business is engaged as a substantial part of its business in an activity described in G.S. 105-163.013(b)(4) if (i) its gross revenues derived from all activities described in that subdivision exceed twenty-five percent (25%) of its gross revenues in any fiscal year or (ii) it is established as one of its primary purposes to engage in any activities described in that subdivision, whether or not its purposes were stated in its articles of incorporation or similar organization documents.~~

~~(10) Security. -- A security as defined in Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1).~~

~~(11) Subordinated debt. -- Indebtedness that (i) by its terms matures five or more years after its issuance, (ii) is not secured, and (iii) is subordinated to all other indebtedness of the issuer issued or to be issued to a financial institution other than a financial institution described in subdivisions (5)(ii) through (5)(v) of this section. Any portion of indebtedness that matures earlier than five years after its issuance is not subordinated debt.~~

(1) Affiliate. -- An individual or business that controls, is controlled by, or is under common control with another individual or business.

(2) Business. -- A corporation, partnership, association, or sole proprietorship operated for profit.

(3) Control. -- A person controls an entity if the person owns, directly or indirectly, more than ten percent (10%) of the voting securities of that entity. As used in this subdivision, the term 'voting security' means a security that (i) confers upon the holder the right to vote for the election of members of the board of directors or similar governing body of the business or (ii) is convertible into, or entitles the holder to receive upon its exercise, a security that confers such a right to vote. A general partnership interest is a voting security.

(4) Equity security. -- Common stock, preferred stock, or an interest in a partnership, or subordinated debt that is convertible into, or entitles the holder to receive upon its exercise, common stock, preferred stock, or an interest in a partnership.

(5) Financial institution. -- A business that is (i) a bank holding company, as defined in the Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841 et seq., or its wholly-owned subsidiary, (ii) registered as a broker-dealer under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq., or its wholly-owned subsidiary, (iii) an investment company as defined in the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq., whether or not it is required to register under that act, (iv) a small business investment company as defined in the Small Business Investment Act of 1958, 15 U.S.C. §§ 661 et seq., (v) a pension or profit-sharing fund or trust, or (vi) a bank, savings institution, trust company, financial services company, or insurance company; provided, however, that a business, other than a small business investment company, is not a financial institution if its net worth, when added to the net worth of all of its affiliates, is less than ten million dollars ($10,000,000); provided further, however, that a

business is not a financial institution if it does not generally market its services to the public and it is controlled by a business that is not a financial institution.

(6) North Carolina Enterprise Corporation. -- A corporation established in accordance with Article 3 of Chapter 53A of the General Statutes or a limited partnership in which a North Carolina Enterprise Corporation is the only general partner.

(7) Pass-through entity. -- An entity or business, including a limited partnership, a general partnership, a joint venture, a Subchapter S Corporation, or a limited liability company, all of which is treated as owned by individuals or other entities under the federal tax laws, in which the owners report their share of the income, losses, and credits from the entity or business on their income tax returns filed with this State. For the purpose of this Division, an owner of a pass-through entity is an individual or entity who is treated as an owner under the federal tax laws.

(8) Qualified business venture. -- A business that (i) engages primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry, and (ii) is registered with the Secretary of State under G.S. 105-163.013.

(9) Qualified grantee business. -- A business that (i) has received during the preceding three years a grant or other funding from the North Carolina Technological Development Authority, the North Carolina Technological Development Authority, Inc., North Carolina First Flight, Inc., the North Carolina Biotechnology Center, the Microelectronics Center of North Carolina, the Kenan Institute for Engineering, Technology and Science, or the Federal Small Business Innovation Research Program, and (ii) is registered with the Secretary of State under G.S. 105-163.013.

(10) Real estate-related business. -- A business that is involved in or related to the brokerage, selling, purchasing, leasing, operating, or managing of hotels, motels, nursing homes or other lodging facilities, golf courses, sports or social clubs,

restaurants, storage facilities, or commercial or residential lots or buildings is a real estate-related business, except that a real estate-related business does not include (i) a business that purchases or leases real estate from others for the purpose of providing itself with facilities from which to conduct a business that is not itself a real estate-related business or (ii) a business that is not otherwise a real estate-related business but that leases, subleases, or otherwise provides to one or more other persons a number of square feet of space which in the aggregate does not exceed fifty percent (50%) of the number of square feet of space occupied by the business for its other activities.

(11) Security. -- A security as defined in Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1).

(12) Selling or leasing at retail. -- A business is selling or leasing at retail if the business either (i) sells or leases any product or service of any nature from a store or other location open to the public generally or (ii) sells or leases products or services of any nature by means other than to or through one or more other businesses.

(13) Service-related industry. -- A business is engaged in a service-related industry, whether or not it also sells a product, if it provides services to customers or clients and does not as a substantial part of its business engage in a business described in G.S. 105-163.013(b)(4). A business is engaged as a substantial part of its business in an activity described in G.S. 105-163.013(b)(4) if (i) its gross revenues derived from all activities described in that subdivision exceed twenty-five percent (25%) of its gross revenues in any fiscal year or (ii) it is established as one of its primary purposes to engage in any activities described in that subdivision, whether or not its purposes were stated in its articles of incorporation or similar organization documents.

(14) Subordinated debt. -- Indebtedness that (i) by its terms matures five or more years after its issuance, (ii) is not secured, and (iii) is subordinated to all other indebtedness of the

issuer issued or to be issued to a financial institution other than a financial institution described in subdivisions (5)(ii) through (5)(v) of this section. Any portion of indebtedness that matures earlier than five years after its issuance is not subordinated debt."

Section 6. G.S. 105-163.1(8) is repealed.

Section 7. G.S. 105-164.3(15) reads as rewritten:

"(15) ~~"Sale"~~ Sale or selling. -- The transfer of title or possession of tangible personal property, conditional or otherwise, in any manner or by any means whatsoever, for a consideration paid or to be paid.

The term includes the fabrication of tangible personal property for consumers by persons engaged in business who furnish either directly or indirectly the materials used in the fabrication work. The term also includes the furnishing or preparing for a consideration of any tangible personal property consumed on the premises of the person furnishing or preparing the property or consumed at the place at which the property is furnished or prepared. The term also includes a transaction in which the possession of the property is transferred but the seller retains title or security for the payment of the consideration.

If a retailer engaged in the business of selling prepared food and drink for immediate or on-premises consumption also gives prepared food or drink to its patrons or employees free of charge, for the purposes of this Article the property given away is considered sold along with the property sold. If a retailer gives an item of inventory to a customer free of charge on the condition that the customer purchase similar or related property, the item given away is considered sold along with the item sold. In all other cases, property given away or used by any retailer or wholesale merchant is not considered sold, whether or not the retailer or wholesale merchant recovers its cost of the property from sales of other property."

Section 8. G.S. 105-236(5)d. reads as rewritten:

"d. No double penalty. -- If a penalty is assessed under subdivision (6) of this section, no

additional penalty for negligence shall be assessed with respect to the same deficiency."

Section 9. G.S. 105-253(b)(3) reads as rewritten:

"(3) All taxes due from the corporation pursuant to the provisions of ~~Article~~ Articles 36C and 36D of Subchapter V of this Chapter and all taxes payable under those Articles by the corporation to a supplier for remittance to this State or another state."

Section 10. G.S. 105-277.4(c) reads as rewritten:

"(c) Property meeting the conditions for classification under G.S. 105-277.3 shall be taxed on the basis of the value of the property for its present use. The difference between the taxes due on the present-use basis and the taxes which would have been payable in the absence of this classification, together with any interest, penalties or costs that may accrue thereon, shall be a lien on the real property of the taxpayer as provided in G.S. 105-355(a). The difference in taxes shall be carried forward in the records of the taxing unit or units as deferred taxes, but shall not be payable, unless and until the property loses its eligibility for the benefit of this classification. Except as otherwise allowed under G.S. 105-277.3, property loses its eligibility for the benefit of this classification if it no longer meets any requirement for classification. The tax for the fiscal year that opens in the calendar year in which a disqualification occurs shall be computed as if the property had not been classified for that year, and taxes for the preceding three fiscal years which have been deferred as provided herein, shall immediately be payable, together with interest thereon as provided in G.S. 105-360 for unpaid taxes which shall accrue on the deferred taxes due herein as if they had been payable on the dates on which they originally became due. If only a part of the qualifying tract of land loses its eligibility, a determination shall be made of the amount of deferred taxes applicable to that part and that amount shall become payable with interest as provided above. Upon the payment of any taxes deferred in accordance with this section for the three years immediately preceding a disqualification, all liens arising under this subsection shall be extinguished."

Section 11. G.S. 105-330.2(a) reads as rewritten:

"(a) The value of a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(1) shall be determined as follows:

(1) For a vehicle registered under the staggered system, the value shall be determined annually as

of January 1 preceding the date a new registration is applied for or the current registration expires.

(2) For a vehicle newly registered under the annual system, the value shall be determined as of January 1 of the year the new registration is obtained. For a vehicle whose registration is renewed under the annual system, the value shall be determined as of January 1 following the date the registration expires.

If the value of a new motor vehicle cannot be determined as of the date specified above, the value of that vehicle shall be determined for that year as of the date that model vehicle is first offered for sale at retail in this State. The ownership, situs, and taxability of a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(1) shall be determined annually as of the day on which a new registration is applied for or the day on which the current vehicle registration is renewed, regardless of whether the registration is renewed after it has expired.

The value of a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(2) shall be determined as of January 1 of the year in which the motor vehicle is required to be listed pursuant to G.S. 105-330.3(a)(2). The ownership, situs, and taxability of a classified motor vehicle listed or discovered pursuant to G.S. 105-330.3(a)(2) shall be determined as of January 1 of the year in which the motor vehicle is required to be listed."

Section 12. G.S. 105-449.95(a) reads as rewritten:

"(a) Calculation. -- At the end of each calendar quarter, the Secretary must review the amount of discounts each licensed distributor or licensed importer received under G.S. 105-449.93(b). The Secretary must determine if the amount of discounts the distributor or importer received under that subsection in each month of the quarter is less than the amount the distributor or importer would have received if the distributor or importer had been allowed a discount on taxable gasoline purchased by the distributor or importer from a supplier during each month of the quarter under the following schedule:

Amount of Gasoline Purchased Each Month	Percentage Discount
First 150,000 gallons	2%
Next 100,000 gallons	1 1/2%
Amount over 250,000 gallons	1%."

Section 13. G.S. 105-449.105(e) reads as rewritten:

"(e) Refund Amount. -- The amount of a refund allowed under this section is the amount of excise tax paid, less the amount of any discount allowed on the fuel under G.S. 105-449.93."

Section 14. G.S. 105-449.106 reads as rewritten:

"**§ 105-449.106. Quarterly refunds for certain local governmental entities, nonprofit organizations, and taxicabs.**

(a) Government and Nonprofits. -- A local governmental entity or a nonprofit organization listed below that purchases and uses motor fuel may receive a quarterly refund, for the excise tax paid during the preceding quarter, at a rate equal to the amount of the flat cents-per-gallon rate plus the variable cents-per-gallon rate in effect during the quarter for which the refund is claimed, less one cent (1¢) per gallon. Any of the following entities may receive a refund under this section:

(1) A county or a municipal corporation.
(2) A private, nonprofit organization that transports passengers under contract with or at the express designation of a unit of local government.
(3) A volunteer fire department.
(4) A volunteer rescue squad.
(5) A sheltered workshop recognized by the Department of Human Resources.

An application for a refund allowed under this section must be made in accordance with this Part and must be signed by the chief executive officer of the entity. The chief executive officer of a nonprofit organization is the president of the organization or another officer of the organization designated in the charter or bylaws of the organization.

(b) Taxi. -- A person who purchases and uses motor fuel in a taxicab, as defined in G.S. 20-87(1), while the taxicab is engaged in transporting passengers for hire, or in a bus operated as part of a city transit system that is exempt from regulation by the North Carolina Utilities Commission under G.S. 62-260(a)(8), may receive a quarterly refund, for the excise tax paid during the preceding quarter, at a rate equal to the flat cents-per-gallon rate plus the variable cents-per-gallon rate in effect during the quarter for which the refund is claimed, less one cent (1¢) per gallon. An application for a refund must be made in accordance with this Part."

Section 15. G.S. 105-449.107 reads as rewritten:

"**§ 105-449.107. Annual refunds for off-highway use and use by certain vehicles with power attachments.**

(a) Off-Highway. -- A person who purchases and uses motor fuel for a purpose other than to operate a licensed highway vehicle

may receive an annual refund for the excise tax the person paid on fuel used during the preceding calendar year at a rate equal to the amount of the flat cents-per-gallon rate in effect during the year for which the refund is claimed plus the average of the two variable cents-per-gallon rates in effect during that year, less one cent (1¢) per gallon. An application for a refund allowed under this section must be made in accordance with this Part.

(b) Certain Vehicles. -- A person who purchases and uses motor fuel in one of the vehicles listed below may receive an annual refund for the amount of fuel consumed by any of the following vehicles:

(1) A concrete mixing vehicle.
(2) A solid waste compacting vehicle.
(3) A bulk feed vehicle that delivers feed to poultry or livestock and uses a power takeoff to unload the feed.
(4) A vehicle that delivers lime or fertilizer in bulk to farms and uses a power takeoff to unload the lime or fertilizer.
(5) A tank wagon that delivers alternative fuel, as defined in G.S. 105-449.130, or motor fuel or another type of liquid fuel into storage tanks and uses a power takeoff to make the delivery.

The refund rate shall be computed by subtracting one cent (1¢) from the combined amount of the flat cents-per-gallon rate in effect during the year for which the refund is claimed and the average of the two variable cents-per-gallon rates in effect during that year, and multiplying the difference by thirty-three and one-third percent (33 1/3%). An application for a refund allowed under this section shall be made in accordance with this Part. This refund is allowed for the amount of fuel consumed by the vehicle in its mixing, compacting, or unloading operations, as distinguished from propelling the vehicle, which amount is considered to be one-third of the amount of fuel consumed by the vehicle."

Section 16. G.S. 105-449.108 reads as rewritten:

"**§ 105-449.108. When an application for a refund is due.**

(a) Annual Refunds. -- An application for an annual refund of excise tax is due by April 15 following the end of the calendar year for which the refund is claimed. The application must state whether or not the applicant has filed a North Carolina income tax return for the preceding taxable year, and must state that the applicant has paid for the fuel for which a refund is claimed

or that payment for the fuel has been secured to the seller's satisfaction.

(b) Quarterly Refunds. -- An application for a quarterly refund of excise tax is due by the last day of the month following the end of the calendar quarter for which the refund is claimed. The application must state that the applicant has paid for the fuel for which a refund is claimed or that payment for the fuel has been secured to the seller's satisfaction.

(c) Upon Application. -- An application for a refund of excise tax upon application under G.S. 105-449.105 is due by the last day of the month that follows the payment of tax or other event that is the basis of the refund."

Section 17. G.S. 117-19(c), (d), and (e) are repealed.

Section 18. G.S. 119-15(5) reads as rewritten:

"**§ 119-15. Definitions that apply to Article.**

The following definitions apply in this Article:

(5) Kerosene supplier. -- Either of the following:

a. A person who supplies both kerosene and motor fuel and, consequently, is required to be licensed under Part 2 of Article 36C of Chapter 105 of the General Statutes.

b. A person who is not required to be licensed as a supplier under Part 2 of Article 36C of Chapter 105 of the General Statutes and who maintains storage facilities for kerosene to be used to fuel an airplane."

Section 19. G.S. 119-16.2(a) reads as rewritten:

"(a) When Required. -- A person may not engage in business as a kerosene supplier unless the person is licensed under Part 2 of Article 36C of Chapter 105 of the General Statutes or has a kerosene supplier license issued under this section. A kerosene distributor is required to have a kerosene distributor license only if the distributor imports kerosene. Other kerosene distributors may elect to have a kerosene distributor license. A licensed kerosene distributor that buys kerosene from a supplier licensed under Part 2 of Article 36C of Chapter 105 of the General Statutes has the right to defer payment of the inspection tax until the supplier is required to remit the tax to this State or another state. A licensed kerosene distributor that pays the tax due a supplier licensed under that Part by the date the supplier must pay the tax to the State may deduct from the amount due a discount in the amount set in G.S. 105-449.93."

Section 20. G.S. 159-48(c) reads as rewritten:

"(c) Each county is authorized to borrow money and issue its bonds under this Article in evidence ~~thereof~~ of the debt for the purpose of, in the case of subdivisions (1) ~~to (4), inclusive,~~ through (4a) of this subsection, paying any capital costs of any one or more of the purposes ~~mentioned therein~~ and, in the case of subdivision ~~(5), to finance the cost thereof:~~ (5) of this subsection, to finance the cost of the purpose:

(1) Providing community college facilities, including without limitation buildings, plants, and other facilities, physical and vocational educational buildings and facilities, including in connection therewith classrooms, laboratories, libraries, auditoriums, administrative offices, student unions, dormitories, gymnasiums, athletic fields, cafeterias, utility plants, and garages.

(2) Providing courthouses, including without limitation offices, meeting rooms, court facilities and rooms, and detention facilities.

(3) Providing county homes for the indigent and infirm.

(4) Providing school facilities, including without limitation schoolhouses, buildings, plants and other facilities, physical and vocational educational buildings and facilities, including in connection therewith classrooms, laboratories, libraries, auditoriums, administrative offices, gymnasiums, athletic fields, lunchrooms, utility plants, garages, and school buses and other necessary vehicles.

(4a) Providing improvements to subdivision and residential streets pursuant to G.S. 153A-205.

(5) Providing for the octennial revaluation of real property for taxation."

Section 21. G.S. 159I-30(e) reads as rewritten:

"(e) Special obligation bonds and notes shall be special obligations of the unit of local government issuing them. The principal of, and interest and any premium on, special obligation bonds and notes shall be payable solely from any one or more of the sources of payment authorized by this section as may be specified in the proceedings, resolution, or trust agreement under which they are authorized or secured. Neither the faith and credit nor the taxing power of the unit of local government are pledged for the payment of the principal of, or interest or any premium on, any special obligation bonds or notes, and no owner of special obligation bonds or notes has the right to

compel the exercise of the taxing power by the unit in connection with any default thereon. Every special obligation bond and note shall recite in substance that the principal and interest and any premium on ~~such~~ the bond or note are payable solely from the sources of payment specified in the bond order or ~~trust,~~ trust agreement under which it is authorized or secured, ~~provided that:~~ if the following conditions are met:

(1) Any such use of ~~such~~ these sources will not constitute a pledge of the unit's taxing power; and

(2) The municipality is not obligated to pay ~~such~~ the principal or interest or premium except from ~~such~~ these sources."

Section 22. This act does not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended or repealed by this act before the effective date of its amendment or repeal; nor does it affect the right to any refund or credit of a tax that accrued under the amended or repealed statute before the effective date of its amendment or repeal.

Section 23. Section 2 of this act is effective January 1, 1997, and applies to the estates of decedents dying on or after that date. The remainder of this act is effective when it becomes law.

Explanation - Revenue Laws Technical Changes

This proposal makes numerous technical and clarifying changes to the revenue laws and related statutes. The following table provides a section-by-section analysis of the proposed changes.

Section	Explanation
1	Repeals an obsolete statute that requires gun owners to list their guns for property taxes. This statute is not needed because nonbusiness personal property is exempt from property taxes and the listing requirements for business personal property are contained in the Machinery Act..
2	Increases the inheritance tax return filing threshold for Class A beneficiaries from $450,000 to $600,000 to conform to the increased credit enacted in 1996.
3 - 4	Correct incorrect cross-references and modernize language.
5	Places definitions in alphabetical order and renumbers them.
6	Deletes the definition of a term that is not used in the Article.
7	Removes improper quotation marks.
8	Restores language that was inadvertently deleted in 1996 due to a redlining error.
9	Corrects a grammatical error.
10	Clarifies that an owner is liable for deferred taxes that have accrued on property valued at its present use whenever the property loses its eligibility for present use value classification. The clarification codifies the Department's long-standing interpretation of the use value program.
11	Restores the missing word "the."
12	Restores the missing word "or."
13 - 16	Make it clear that the per gallon motor fuel tax refunds do not apply to the inspection tax.
17	Repeals three obsolete subsections concerning taxes payable by electric membership corporations for 1965 and 1966.
18 - 19	Make it clear that a motor fuel supplier that sells kerosene is not required to have a separate license as a kerosene supplier.
20	Makes a conforming change to a cross-reference and modernizes language.
21	Deletes an improper comma.
22	Provides a savings clause.
23	Provides the effective date of the act.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S/H **D**

Legislative Proposal 17
97-RBZ-024(1.1)*
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Permanent Revenue Laws Study Committee. (Public)

Sponsors: Senators Kerr, Cochrane, Cooper, Shaw, and Soles.
Representives Neely, Blue, Cansler, Capps, Church, Robinson, and Shubert.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CREATE A STATUTORY REVENUE LAWS STUDY COMMITTEE.

Whereas, the Legislative Research Commission has been authorized by the 1977, 1979, 1981, 1983, 1985, 1987, 1989, 1991, and 1993 General Assemblies to conduct a study of the revenue laws of North Carolina; and

Whereas, since 1977 the committee appointed by the Legislative Research Commission to study the revenue laws has recommended many changes in the revenue laws in the committee's attempt to improve these laws; and

Whereas, the Revenue Laws Study Committee has proved to be an excellent forum for both taxpayers and tax administrators to present their complaints about existing law and make suggestions to improve the law;

Now, therefore, the General Assembly of North Carolina enacts:

Section 1. Chapter 120 of the General Statutes is amended by adding a new article to read:

"ARTICLE 12L.

Revenue Laws Study Committee.

§ 120-70.105. Creation and membership of the Revenue Laws Study Committee.

The Revenue Laws Study Committee is established. The Committee consists of 16 members as follows:

(1) Eight members appointed by the President Pro Tempore of the Senate; the persons appointed may be members of the Senate or public members.

(2) Eight members appointed by the Speaker of the House of Representatives; the persons appointed may be members of the House of Representatives or public members.

Terms on the Committee are for two years and begin on January 15 of each odd-numbered year, except the terms of the initial members, which begin on appointment. Legislative members may complete a term of service on the Committee even if they do not seek reelection or are not reelected to the General Assembly, but resignation or removal from service in the General Assembly constitutes resignation or removal from service on the Committee.

A member continues to serve until his successor is appointed. A vacancy shall be filled within 30 days by the officer who made the original appointment.

§ 120-70.106. Purpose and powers of Committee.

(a) The Revenue Laws Study Committee may:

(1) Study the revenue laws of North Carolina and the administration of those laws.

(2) Review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable.

(3) Call upon the Department of Revenue to cooperate with it in the study of the revenue laws.

(4) Report to the General Assembly at the beginning of each regular session concerning its determinations of needed changes in the State's revenue laws.

These powers, which are enumerated by way of illustration, shall be liberally construed to provide for the maximum review by the Committee of all revenue law matters in this State.

(b) The Committee may make interim reports to the General Assembly on matters for which it may report to a regular session of the General Assembly. A report to the General Assembly may contain any legislation needed to implement a recommendation of the Committee. When a recommendation of the Committee, if enacted, would result in an increase or decrease in State

revenues, the report of the Committee must include an estimate of the amount of the increase or decrease.

§ 120-70.107. Organization of Committee.

(a) The President Pro Tempore of the Senate and the Speaker of the House of Representatives shall each designate a cochair of the Revenue Laws Study Committee. The Committee shall meet upon the joint call of the cochairs.

(b) A quorum of the Committee is nine members. No action may be taken except by a majority vote at a meeting at which a quorum is present. While in the discharge of its official duties, the Committee has the powers of a joint committee under G.S. 120-19 and G.S. 120-19.1 through 120-19.4.

(c) The Committee shall be funded by the Legislative Services Commission from appropriations made to the General Assembly for that purpose. Members of the Committee receive subsistence and travel expenses as provided in G.S. 120-3.1 and G.S. 138-5. The Committee may contract for consultants or hire employees in accordance with G.S. 120-32.02. The Legislative Services Commission, through the Legislative Administrative Officer, shall assign professional staff to assist the Committee in its work. Upon the direction of the Legislative Services Commission, the Supervisors of Clerks of the Senate and of the House of Representatives shall assign clerical staff to the Committee. The expenses for clerical employees shall be borne by the Committee."

Section 2. This act is effective when it becomes law.

Explanation - Permanent Revenue Laws Study Committee
Legislative Proposal 17

This proposal creates a statutory Revenue Laws Study Committee. The Legislative Research Commission has been authorized to conduct a study of the revenue laws of North Carolina for the past twenty years. Since 1977, the Revenue Laws Study Committee has recommended many changes in the revenue laws in the committee's attempt to improve these laws. The Revenue Laws Study Committee has proven to be an excellent forum for both taxpayers and tax administrators to present their complaints about existing laws and make suggestions to improve the law. For these reasons, the Committee recommends the creation of a permanent Revenue Laws Study Committee.

The proposal maintains the structure and scope that the Legislative Research Commission has given the Committee over the past twenty years. It would have sixteen members: eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. The members appointed could be public members or members of the respective appointing authority's house. The members of the Committee would serve for two years.

The proposal gives the study of the revenue laws a broad scope so that the Revenue Laws Study Committee can provide for the maximum review of all revenue law matters in the State. The Committee must report to each regular session of the General Assembly and it may make interim reports as needed. When a recommendation of the Committee, if enacted, would result in an increase or decrease in State revenues, the report of the Committee must include an estimate of the amount of the increase or decrease.

The act is effective when it becomes law.

APPENDIX A

AUTHORIZING LEGISLATION

GENERAL ASSEMBLY OF NORTH CAROLINA
1995 SESSION
RATIFIED BILL

CHAPTER 542
HOUSE BILL 898

AN ACT TO AUTHORIZE STUDIES BY THE LEGISLATIVE RESEARCH COMMISSION, TO CREATE AND CONTINUE VARIOUS COMMISSIONS, TO DIRECT STATE AGENCIES AND LEGISLATIVE OVERSIGHT COMMITTEES AND COMMISSIONS TO STUDY SPECIFIED ISSUES, TO MAKE VARIOUS STATUTORY CHANGES, AND TO MAKE TECHNICAL CORRECTIONS TO CHAPTER 507 OF THE 1995 SESSION LAWS.

The General Assembly of North Carolina enacts:

PART I.-----TITLE

Section 1. This act shall be known as "The Studies Act of 1995".

PART II.-----LEGISLATIVE RESEARCH COMMISSION

Sec. 2.1. The Legislative Research Commission may study the topics listed below. When applicable, the 1995 bill or resolution that originally proposed the issue or study and the name of the sponsor is listed. The Commission may consider the original bill or resolution in determining the nature, scope, and aspects of the study. The topics are:

(19) Revenue and tax issues:
- a. Revenue laws (H.B. 246 - Gamble)
- b. Interstate Tax Agreements (S.J.R. 122 - Webster)
- c. Tax expenditures (H.J.R. 95 - Gamble, Luebke)
- d. Nonprofit continuing care facilities property tax exemption (S.B. 980 - Plexico and Sherron)
- e. Diesel Fuel Payment method (S.B. 797 - Hoyle; H. B. 975 - Barbee)
- f. Taxation of business inventory donated to nonprofit organization (McMahan)

PART XXVI.-----EFFECTIVE DATE

Sec. 26.1. This act is effective upon ratification.

In the General Assembly read three times and ratified this the 29th day of July, 1995.

Dennis A. Wicker
President of the Senate

Harold J. Brubaker
Speaker of the House of Representatives

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1995

H **1**

HOUSE JOINT RESOLUTION 246

Sponsors: Representatives Gamble; Arnold, Luebke, Ramsey, and Tallent.

Referred to: Rules, Calendar and Operations of the House.

February 22, 1995

A JOINT RESOLUTION AUTHORIZING THE LEGISLATIVE RESEARCH COMMISSION TO CONTINUE TO STUDY THE REVENUE LAWS OF NORTH CAROLINA.

Whereas, the Legislative Research Commission has been authorized by the 1977, 1979, 1981, 1983, 1985, 1987, 1989, 1991, and 1993 General Assemblies to conduct a study of the revenue laws of North Carolina; and

Whereas, since 1977 the committee appointed by the Legislative Research Commission to study the revenue laws has recommended many changes in the revenue laws in the committee's attempt to improve these laws; and

Whereas, the Revenue Laws Study Committee has proved to be an excellent forum for both taxpayers and tax administrators to present their complaints about existing law and make suggestions to improve the law;

Now, therefore, be it resolved by the House of Representatives, the Senate concurring:

Section 1. The Legislative Research Commission is authorized to study the revenue laws of North Carolina and the administration of these laws. The Commission may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable. When the recommendations of the Commission, if enacted, would result

in an increase or decrease in State tax revenues, the report of the Commission shall include an estimate of the amount of the increase or decrease.

Sec. 2. The Commission may call upon the Department of Revenue to cooperate with it in its study of the revenue laws. The Secretary of Revenue shall ensure that the Department's staff cooperates fully with the Commission.

Sec. 3. The Commission shall make a final report of its recommendations for improvement of the revenue laws to the 1997 General Assembly and may make an interim report to the 1996 Regular Session of the 1995 General Assembly.

Sec. 4. This resolution is effective upon ratification.

APPENDIX B

MEMBERSHIP OF THE LRC COMMITTEE ON REVENUE LAWS

REVENUE LAWS STUDY COMMITTEE
MEMBERSHIP
1995 - 1996

LRC Member: Sen. R.L. Martin
126 Nelson Street
PO Box 387
Bethel, NC 27812
(919) 825-4361

President Pro Tempore Appointments

Sen. John H. Kerr, III, Cochair
PO Box 1616
Goldsboro, NC 27533
(919) 734-1841

Sen. Betsy L. Cochrane
122 Azalea Circle
Advance, NC 27006
(910) 998-8893

Sen. Roy A. Cooper, III
PO Drawer 4538
Rocky Mount, NC 27803
(919) 442-3115

Dr. James Crapo
Duke University Medical Center
Box 3177
Durham, NC 27710
(919) 684-6266

Mr. Leonard Jones
300 North 35th Street
Morehead City, NC 28577-3106
(919) 247-4625

Mr. James Seay
Seay, Titchner and Horne
PO Box 18807
Raleigh, NC 27619
(919) 876-4100

Sen. R.C. Soles, Jr.
PO Box 6
Tabor City, NC 28463
(910) 653-2015

Speaker's Appointments

Rep. Charles B. Neely, Jr., Cochair
3065 Granville Drive
Raleigh, NC 27609
(919) 782-3845

Rep. Daniel T. Blue, Jr.
PO Box 1730
Raleigh, NC 27602
(919) 833-1931

Rep. Lanier M. Cansler
14 Laurel Summit
Asheville, NC 28803
(704) 298-8514

Rep. J. Russell Capps
7204 Halstead lane
Raleigh, NC 27613
(919) 846-9199

Rep. Walter G. Church, Sr.
PO Box 760
Valdese, NC 28690
(704) 874-2141

Rep. George S. Robinson
PO Box 1558
Lenoir, NC 28645
(704) 728-2902

Rep. Larry Shaw
PO Box 1195
Fayetteville, NC 28302
(910) 323-5303

Rep. Fern H. Shubert
106 East Main Street
Marshville, NC 28103
(704) 624-2720

Staff:

Ms. Martha Harris
Bill Drafting Division
(919) 733-6660

Ms. Sabra Faires
Mr. Warren Plonk
Mr. Richard Bostic
Fiscal Research Division
(919) 733-4910

Ms. Cindy Avrette
Research Division
(919) 733-2578

Clerk:

Ms. Evelyn Hartsell
(919) 733-5621

APPENDIX C

SUMMARY OF 1996 TAX LAW CHANGES

1996 Tax Law Changes

Prepared by Cindy Avrette, Sabra J. Faires, and Martha H. Harris

1996 Second Extra Session

Chapter 13, 1996 Second Extra Session (House Bill 18, Representative Gray)

AN ACT TO REDUCE TAXES FOR THE CITIZENS OF NORTH CAROLINA AND TO PROVIDE INCENTIVES FOR HIGH QUALITY JOBS AND BUSINESS EXPANSION IN NORTH CAROLINA

This act is the William S. Lee Quality Jobs and Business Expansion Act. It represents the major tax reduction legislation passed in 1996 by the 1995 General Assembly. The act cuts taxes by $186.5 million in fiscal year 1997-98. This act, coupled with the 1995 tax cuts, reduce taxes by more than $624 million in fiscal year 1997-98. The act does many things: it reduces the sales tax on food, reduces the corporate income tax, provides tax credits for quality jobs and business expansion, phases out the excise tax on soft drinks, modifies the bundled transaction sales tax, reduces inheritance and gift taxes, creates a nonitemizer charitable contribution tax credit, excludes certain severance pay from income tax, and reduces the sales tax on farm and industry fuel. Other major tax cuts were made in Senate Bill 6, ratified as Chapter 14 of the 1996 Second Extra Session, in House Bill 30, ratified as Chapter 19 of the 1996 Second Extra Session, and in House Bill 53, ratified as Chapter 18 of the 1996 Second Extra Session.

Reduce Sales Tax on Food

Under current law, food stamp items that are purchased with food stamps are exempt from both State and local sales taxes, and food stamp items that are not purchased with food stamps are subject to both the State 4% sales tax and the local 2% sales tax. Effective January 1, 1997, this act reduces the State sales tax on food stamp items from 4% to 3% but does not repeal or reduce the local sales tax on these items. This part of the act reduces General Fund revenues by $36.7 million in fiscal year 1996-97 and by $87 million in fiscal year 1997-98.

Federal law determines what can be purchased with food stamps and, therefore, what would be exempt from State sales tax under this act. Food stamps can be used to purchase the following from a retailer that has decided to participate in the food stamp program: food for humans for home consumption, seeds and plants for use in gardens to produce food for human consumption, and certain meals served by meal delivery services and communal dining facilities.

Examples of food items that would be exempt are fruits, vegetables, bread, meat, fish, milk, snack foods such as candy, gum, soft drinks, and chips, distilled water, ice, tomato plants, fruit trees, and cold prepared food for home consumption. Items that are not considered food items under federal law and would therefore remain subject to tax include alcoholic beverages, tobacco products, pet food, prepared foods that are hot at the point of sale and are therefore ready for immediate consumption, such as a broiled chicken kept in a heated display case, and

food, such as a hamburger, a pastry, or soup, that is marketed to be heated on the premises of the retailer in a microwave oven or other heating device.

Food has been subject to sales tax in North Carolina since 1961. From the enactment of the sales tax in 1933 until 1961, either essential food items or food purchased for home consumption was exempt, except during the two years from 1935 to 1937.

Reduce Corporate Income Tax

Part II of the act reduces the corporate income tax rate from 7.75% to 6.9% over a four-year period, beginning with tax year 1997. This part of the act will reduce General Fund revenues by $14.2 million in fiscal year 1996-97, $46.2 million in fiscal year 1997-98, $79 million in fiscal year 1998-99, $103.2 million in fiscal year 1999-2000, and $110.2 million in fiscal year 2000-01. The act also adjusts the percentage of corporate tax revenue that is automatically credited to the Public School Building Capital Fund to keep the amount of revenue that goes to this Fund at its current level.

Until 1987, North Carolina's corporate income tax rate was 6% of a corporation's State net income. In 1987, as part of a tax package that included repeal of the property tax on inventories, the corporate income tax was increased to 7%. One-half of the additional 1% was dedicated to public school capital needs. In 1991, as part of a legislative package that cut spending and raised revenues to make up a $1.2 billion shortfall, the corporate income tax rate was increased to 7.75% and a 4% surtax was enacted. The surtax was phased out over four years and expired January 1, 1995.

Quality Jobs and Business Expansion Tax Credits

The act establishes several tax incentives to encourage new and expanding businesses and a general business tax credit that will be more beneficial for small and existing businesses. With the exception of the worker training tax credit, the tax credits become effective for taxable years beginning on or after January 1, 1996, and apply to property placed in service and jobs created on or after August 1, 1996, and to research and development expenditures made on or after July 1, 1996. The worker training credit becomes effective January 1, 1997, and applies to training expenses made on or after July 1, 1997.

All of the credits are allowed against either the franchise tax or the income taxes; they may not exceed 50% of the tax against which they are claimed for the taxable year, and any unused credit may be carried forward for the succeeding five years. It is estimated that the credits will reduce General Fund revenues by more than $19 million in fiscal year 1997-98; this loss will increase to more than $72 million by fiscal year 2000-01. Reports will be submitted each year detailing the number of credits claimed, the number of new jobs created, the cost of tangible personal property with respect to which credits were claimed, and the costs to the General Fund of the credits claimed. The credits will expire January 1, 2002.

The tax incentives for new and expanding businesses were part of the Governor's proposals for economic development and were designed and recommended by the Governor's Economic Development Board. They include expansion of the current jobs tax credit and establishment of new tax credits for worker training expenses, for increasing research activities, and for investing in machinery and equipment. To be eligible for the credits, a taxpayer must

engage in manufacturing or processing, warehousing or distributing, or data processing and the jobs must pay at least 10% above the average weekly wage in the county where the job is created.

The act expands the current jobs tax credit to include all 100 counties, to include data processing and warehousing and distribution jobs, to include employers with five or more employees, to apply to corporate franchise tax as well as corporate and individual income tax, and to significantly increase the amount of the credit for the most distressed counties. The current credit applies to 50 counties, is limited to manufacturing and processing jobs, is limited to employers with nine or more employees, is limited to corporate and individual income tax, and is a set amount ($2,800) in all 50 counties. The act divides the counties into five "enterprise tiers" based on their per capita income, unemployment rate, and population growth. The ten poorest counties are in tier one and the next fifteen counties are in tier two. The remaining seventy-five counties are divided evenly among tiers three, four, and five. The jobs tax credit is $12,500 for each eligible new job created in an enterprise tier one area, $4,000 in a tier two area, $3,000 in a tier three area, $1,000 in a tier four area, and $500 in a tier five area.

The worker training tax credit applies to expenses to train an employee for whom a jobs tax credit is allowed. The credit is 50% of the eligible training expenses, not to exceed $1,000 per worker in enterprise tier one counties and $500 per worker in other counties. The eligibility of training expenses is certified by the Community College system based on existing requirements for State-funded training for new and expanding industry.

The research and development tax credit uses the federal credit as its starting point. The credit is equal to 5% of eligible expenses incurred in North Carolina. Congress has reenacted the federal research and development credit for the period July 1, 1996, to June 30, 1997.

The credit for investment in machinery and equipment applies to property placed in service in this State and capitalized by the taxpayer for tax purposes under the Code. The credit is 7% of the cost of the taxpayer's net new investment that exceeds the county's threshold amount. The threshold amount varies depending on the county's enterprise tier, as indicated in the following table:

Enterprise Tier	Threshold
Tier One	$ -0-
Tier Two	100,000
Tier Three	200,000
Tier Four	500,000
Tier Five	1,000,000

The credit must be taken in seven equal installments, beginning the year after the equipment is placed in service.

The act also provides a tax credit for investing in tangible personal property that is used by the taxpayer in connection with a business or for the production of income and is capitalized by the taxpayer for tax purposes under the Code. The amount of the credit is 4.5% of the cost of the property placed in service, not to exceed $4,500 per taxpayer per year. The credit must be taken in five equal installments beginning in the year the property is placed in service. This credit is less restricted than the credit for investment in machinery and equipment in that there is no minimum wage requirement, no minimum amount of investment requirement, and no type of business requirement.

The act provides several benefits for the ten poorest counties, which are in enterprise tier one. These counties will have access to a special Utility Account within the Industrial Development Fund of the Department of Commerce. The General Assembly appropriated $2 million to this account in the Current Operations Appropriations Act of 1996. The money in the Utility Account can be used for construction or improvements to new or existing water, sewer, gas, or electrical utility distribution lines or for existing, new, or proposed industrial buildings to be used in manufacturing and processing, warehousing and distribution, or data processing. Enterprise tier one counties will also be exempt from local match requirements for Industrial Development Fund grants and loans and Community Development Block Grants Economic Development grants and loans. To the extent practical, they will receive priority consideration for Community Development Block Grant Economic Development financing.

The act also expands the Industrial Development Fund program in all counties by increasing the maximum grant or loan from $2,400 per job to $4,000 per job, and from $250,000 per project to $400,000 per project. Finally, the act directs the Department of Commerce to annually review the level of development in each of the State's multi-county economic regions and to strive for balance and equality of development within each region.

Phase Out Soft Drink Tax

During the 1995 Regular Session, the General Assembly reduced the excise tax on soft drinks by 25%, effective July 1, 1996. This act continues the reduction started in 1995 by phasing out the tax over a three-year period, beginning July 1, 1997. This part of the act, when fully implemented in fiscal year 1999-2000, will reduce General Fund revenues by $31.8 million.

The soft drink excise tax was enacted in 1969. The purpose of the tax is to provide an additional source of revenue to the General Fund. A soft drink is defined as a beverage that is not an alcoholic beverage. An alcoholic beverage is a beverage containing at least 0.5% alcohol.

Modify Bundled Transaction Sales Tax

This part of the act specifies how the amount of State and local sales and use tax due on a "bundled transaction" is to be calculated. Its primary application is in the taxation of cellular phones transferred at no cost or substantially below cost in conjunction with agreements to obtain cellular phone service for a specified minimum period of time. The provision becomes effective November 1, 1996, and is expected to reduce General Fund revenues by $6.7 million a year and local government revenues by $3.3 million a year.

As defined in the act, a "bundled transaction" is one in which an item, such as a cellular phone, is transferred without charge or below the seller's cost on condition that the purchaser enter into an agreement to purchase services for at least six months and to pay a cancellation fee if the purchaser cancels the service agreement before the end of the minimum period. Under current law, when an item is transferred in a bundled transaction, the seller is liable for use tax computed on the wholesale cost of the item. If, for example, a retailer gives a phone away in conjunction with a service agreement or sells a phone for $1 in conjunction with a service agreement and the wholesale cost of the phone to the retailer is $100, a tax of $6 (6% of $100) is due. To base the tax due on the amount charged for the item would produce the anomalous result that $6 use tax is due if the retailer gives the phone away but only 6¢ sales tax is due if the

retailer "charges" $1 for the phone.

Under the act, tax is due on any price, such as $1, charged for the item when the transaction occurs and is due on the difference between the price charged and the normal retail price of the item only if the services the purchaser agrees to receive are not subject to a tax of at least 6%. If the services the purchaser agrees to receive are subject to a tax of at least 6%, no tax is due on the balance of the retail price of the item transferred unless the purchaser cancels the service agreement and is required to pay the cancellation fee. If this occurs, tax is due on the amount of the cancellation fee.

The effect of the act is to exclude part or all of the retail price of a cellular phone from sales and use tax when the phone is transferred in a bundled transaction. This would occur because telephone service is subject to a tax of at least 6% (State sales and use tax combined with State gross receipts franchise taxes). Cellular phones sold in transactions that are not bundled with service agreements would continue to be subject to State sales and use tax based on the retail price and the telephone service acquired to use the phone would also be taxed. Thus, under the act, if a person is charged $1 in a bundled transaction for a cellular phone that has a wholesale value of $100 and a retail value of $160, the person will pay tax of 6¢ (6% of $1). If that person buys the same phone in a transaction that is not bundled, the person will pay tax of $9.60 (6% of $160). Under current law, the person would pay $6 tax in the bundled transaction and $9.60 in the unbundled transaction.

Reduce Inheritance and Gift Taxes

This part of the act increases the Class A inheritance tax credit from $26,150 to $33,150, adopts the federal estate and gift tax provisions on qualified terminable interest trusts, prevents a double deduction for certain administrative expenses, and allows for the installment payment of inheritance taxes on closely held businesses and farms. The inheritance and gift tax changes become effective January 1, 1997, and apply to the estates of decedents dying on or after that date and to gifts made on or after that date. The changes will reduce General Fund revenues by $3.5 million a year beginning in fiscal year 1997-98.

North Carolina inheritance and gift tax rates are based on the relationship of the person transferring the property to the person receiving the property. State law classifies beneficiaries into three classes, Class A, Class B, and Class C, and sets different tax rates for each class. A Class A beneficiary is a lineal ancestor, a lineal descendant, an adopted child, a step-child, or a son-in-law or daughter-in-law whose spouse is not entitled to any of the decedent's property; a Class B beneficiary is a sibling, a descendant of a sibling, or an aunt or uncle by blood; and a Class C beneficiary is anyone who is not a Class A or Class B beneficiary. Class A beneficiaries have the lowest tax rates, Class B beneficiaries have higher rates, and Class C beneficiaries have the highest rates. Thus, North Carolina's rate structure favors transfers to children and parents by giving these transfers the lowest rates and prefers transfers to other close family members over transfers to more distant relatives or to persons who are not related by giving these transfers the in-between rate.

North Carolina's inheritance and gift tax laws are in contrast to federal law, which has a single rate schedule for gifts and estates. As under federal law, however, all transfers to a spouse are exempt from State inheritance and gift taxes. The Revenue Laws Study Committee

recommended to the 1996 General Assembly that the current inheritance tax be phased out over five years and that the federal "pick-up" tax, which is the federal state death tax credit, be retained as the State estate tax.

The 1996 General Assembly did not choose to phase out the tax, but it did increase the Class A beneficiary inheritance tax credit so that the amount exempted by the credit would be the same as the amount that is exempted from federal estate and gift taxes by application of the federal unified credit. The federal unified credit is $192,800, which exempts $600,000 of property from federal estate or gift taxes. The federal credit is unified in that it applies to both federal estate and gift taxes. Any part of the credit that is not used on gift taxes is applied to estate taxes.

The State Class A inheritance tax credit is not a unified credit. It does not apply to State gift taxes. State law provides a separate $100,000 lifetime exemption for gifts made to Class A beneficiaries. Under current law, therefore, the combination of the State gift tax lifetime exemption for Class A beneficiaries and the Class A inheritance tax credit exempts the same amount of property as the federal unified credit. Under this act, the increase in the Class A inheritance tax credit to $33,150 will exempt an additional $100,000 from inheritance tax. If a person fully uses both the State $100,000 gift tax lifetime exemption and the State Class A inheritance tax credit, the person can exempt more property from gift and inheritance taxes under State law than under federal law.

The act further conforms to federal law by exempting from State inheritance and gift tax property that is exempt from federal estate and gift taxes because it is considered qualified terminable interest property (QTIP property). Conforming to federal law on this topic will provide consistent treatment at the federal and State level. Also, because this type of property is more like an outright transfer to a spouse than it is like any other kind of transfer, this act intends to further the State's policy of exempting transfers to spouses from inheritance or gift tax by providing that no inheritance tax will be due until the spouse subsequently dies and passes the property on to the ultimate beneficiaries.

QTIP property is property placed in a trust in which a person's spouse has an income interest for life and the person's children or other designated beneficiaries have a remainder interest. Under federal law, a transfer of property that qualifies as QTIP property is not taxable when the transfer is made. Instead, it is taxed when the spouse who had the lifetime income interest in the property dies. At that time, the value of the QTIP property is included in the spouse's gross estate.

Under current North Carolina law, when property is transferred by means of a QTIP trust, two transfers are considered to have been made. One transfer is the transfer to the spouse of a life estate in the trust income. The transfer of the life estate to the spouse is not taxed because all property that passes to a spouse is exempt from State inheritance and gift taxes. The value of the spouse's life estate is the present value of the stream of income based on the life expectancy of the spouse. The other transfer is a transfer of the remainder interest in the trust property to the transferor's children or other designated beneficiaries. The transfer of the remainder interest is subject to inheritance or gift tax. The value of the remainder interest is its present value as of the date of death or date of the gift.

Under this act, the remainder interest in QTIP property would no longer be taxable under North Carolina law when the QTIP trust is established. Instead, it would be taxable when the

spouse with the life estate in the income died and would be taxed on the basis of the value at the spouse's death. In some cases, taxes would be collected at a later time than under current law, but in other cases less tax would be collected than under current law. Further reductions in tax would occur if the value of the trust property declined over time. No tax would be collected at a later date if the spouse moved out of the State before death and the trust consisted of securities rather than real property located in the State. By the same token, some tax would be collected that is not now collected if a spouse with a QTIP trust moves into the State.

A QTIP trust need not be established before a gift is made or the decedent dies. If the transfer is a gift, the trust can be established any time before the gift tax return is filed. If the transfer is a devise upon death, the trust can be established any time before the estate tax return is due if the will gives the personal representative the option of establishing a QTIP trust. The decision of whether or not to establish a QTIP trust is made after considering tax consequences and other factors.

Current law allows the costs of administering an estate to be deducted when determining the amount of inheritance tax payable on property in the estate. Costs of administration include attorney fees, accountant fees, and executor fees. The law, however, does not limit the inheritance tax deduction to costs that are not deducted on a fiduciary income tax return filed for the estate. If the same cost is deducted on both returns, the taxpayer receives an unintended double deduction for the same item.

A double deduction for the same item of cost is most likely to result when, because of the small size of an estate, no federal estate tax return is filed but a federal fiduciary income tax return is filed. In this instance, all costs will be deducted on the federal fiduciary income tax return.

North Carolina's income tax uses federal taxable income as the starting point in computing North Carolina taxable income. A result of this is that deductions taken on the federal return are automatically passed through on the North Carolina return. Thus, any item that is deducted on the federal fiduciary income tax return is also deducted on the State fiduciary income tax return. To prevent a double deduction, this act prohibits the deduction of an item on an inheritance tax return if the item was deducted on the federal fiduciary income tax return.

Finally, this part of the act allows for the installment payment of inheritance taxes on closely held businesses and farms if the personal representative of the estate elects under section 6166 of the Internal Revenue Code to make annual installment payments of federal estate tax. Payments are due at the same time and in the same proportion to the total tax due as payments due to the Internal Revenue Service under section 6166 of the Code. An acceleration of federal payments will also accelerate the North Carolina payments.

Nonitemizer Charitable Contribution Tax Credit

This part of the act creates an individual income tax credit for charitable contributions made by individuals who do not itemize their deductions. The credit is 2.75% of the amount of charitable contributions that exceed 2% of the individual's adjusted gross income. Two percent is the average percentage of income that North Carolinians contribute to nonprofits. By setting the floor at 2%, the act encourages and acknowledges giving that is above average. It is effective for taxable years beginning on or after January 1, 1997, and will reduce General Fund revenues by

approximately $5 million a year.

Under the federal Internal Revenue Code, an individual who itemizes deductions may deduct contributions to nonprofit charitable organizations. Individuals who elect the standard deduction, however, may not deduct charitable contributions. An individual's North Carolina's income tax is based on the federal calculation of taxable income, with some adjustments. The federal disallowance of charitable deductions for nonitemizers is "piggybacked" by North Carolina tax law, so there is no income tax incentive under federal or North Carolina law for nonitemizers to make charitable contributions. Legislation was introduced in Congress to allow nonitemizers to deduct charitable contributions. If federal legislation were enacted, North Carolina could "piggyback" the federal tax incentive. However, the federal legislation did not pass.

Individuals who elect the standard deduction are those whose total itemized deductions (such as mortgage interest, State and local property and income taxes, medical expenses, and charitable contributions) do not exceed the standard deduction amount. The amount of the standard deduction varies depending upon the individual's filing status. The North Carolina standard deduction amounts for 1996 are $5,000 for a married couple filing a joint return; $4,400 for a head of household; $3,000 for single taxpayer; and $2,500 for a married taxpayer filing separately. Approximately 71% of North Carolina taxpayers elect the standard deduction.

This provision was one of the recommendations of the House of Representatives' Select Committee on Nonprofits; it is intended to increase charitable giving. The Committee studied the question of whether tax incentives make a difference in charitable giving and learned that federal tax incentives probably do but State tax incentives probably do not because the State income tax is so low compared to the federal income tax that it does little to influence individuals' economic decisions. The Committee believed, however, and the General Assembly agreed, that State incentives may affect perceptions, and thus behavior, even if the tax is too small to provide a significant economic incentive.

Exclude Certain Severance Pay from Income Tax

This part of the act exempts from State individual income tax severance pay a taxpayer receives due to the permanent closure of a manufacturing or processing plant, not to exceed a maximum of $35,000 for the taxable year. This part is effective for taxable years beginning on or after January 1, 1996. The exemption will reduce General Fund revenues by approximately $4 million a year.

Reduce Sales Tax On Fuel Used By Farmers and Industry

This part of the act reduces the sales tax rate on electricity and piped natural gas used by farmers, manufacturers, laundries, and dry cleaners from 3% to 2.83%, effective August 1, 1996. This change affects General Fund revenue but not local revenue because no local sales tax applies to electricity and piped natural gas. It will reduce General Fund revenue by over $5 million dollars a year.

Chapter 14, 1996 Second Extra Session (Senate Bill 6, Senator Kerr)

AN ACT TO PROVIDE TAX REFORM AND TAX RELIEF FOR THE CITIZENS OF NORTH CAROLINA BY REPEALING THE UNCONSTITUTIONAL CORPORATE TAX CREDIT FOR NORTH CAROLINA WINE, REPEALING THE UNCONSTITUTIONAL CORPORATE TAX DEDUCTION FOR NORTH CAROLINA DIVIDENDS, REPEALING THE UNCONSTITUTIONAL INDIVIDUAL INCOME TAX CREDIT FOR NORTH CAROLINA DIVIDENDS, REVISING THE UNCONSTITUTIONAL TAX CREDIT FOR QUALIFIED BUSINESS INVESTMENTS, CLARIFYING THE TAX TREATMENT OF REFUNDS OF UNCONSTITUTIONAL TAXES, CLARIFYING THE SALES AND USE TAX TREATMENT OF ITEMS GIVEN AWAY BY MERCHANTS, PROVIDING THE SECRETARY OF REVENUE AUTHORITY TO IMPROVE USE TAX COLLECTION, EXEMPTING FROM SALES AND USE TAX INVENTORY THAT IS DONATED BY A MERCHANT TO A CHARITABLE NONPROFIT ORGANIZATION, AND REPEALING MOST STATE PRIVILEGE LICENSE TAXES.

This act contains several different provisions recommended to the 1995 General Assembly by the Revenue Laws Study Committee. It repeals or revises four North Carolina tax provisions that the Committee identified as having the same flaw as the intangibles tax stock deduction that was declared unconstitutional by the United States Supreme Court in the Fulton decision. In addition, it clarifies the tax treatment of refunds of unconstitutional taxes, extends the time a taxpayer has to challenge the unconstitutionality of a tax from 30 days to one year, enables the State to enter into agreements to accept voluntary payments of State and local use tax, directs the Department of Revenue to instruct mail-order companies to obtain the purchaser's county of residence for proper allocation of use tax revenue, clarifies the sales tax treatment of items given away by merchants, exempts from sales and use tax tangible personal property that is donated by a manufacturer or retailer to a nonprofit organization for a charitable purposes, and repeals most State privilege license taxes. The act results in a revenue gain for the General Fund of approximately $18.27 million in fiscal year 1996-97. After the privilege license repeal becomes effective in 1997, the act will increase General Fund revenues by only about $2 million a year.

Unconstitutional Tax Preferences

The tax preferences addressed in Part I of the act are:

(1) The current $300 individual income tax credit for dividends received from North Carolina companies: Effective for the 1996 tax year, the act repeals this credit.

(2) The $15,000 corporate income tax deduction for dividends received from North Carolina companies: Effective for the 1996 tax year, the act repeals this deduction.

(3) The income tax credits for investing in North Carolina Enterprise Corporations and for qualified business investments in North Carolina companies: The act repeals the credit for investing in North Carolina Enterprise Corporations and the corporate income tax credit for qualified business investments, effective for investments made on or after January 1, 1997. It restricts the remaining tax credits for qualified business investments to those made by individuals or small partnerships directly in qualified businesses and removes the requirement that qualified businesses be headquartered and operating in North Carolina, effective for investments made on or after January 1, 1997. It also caps the

credits at $6 million a year, effective for investments made on or after January 1, 1996.

(4) The North Carolina income tax credit for distributing North Carolina wine: The act repeals this credit effective for the 1996 tax year.

There is no disagreement on whether these tax preferences are flawed. The Attorney General's Office advised the Department of Revenue that, if the General Assembly did not resolve the constitutional problems with these preferences, the Department of Revenue had the option of either denying the preferences to North Carolina companies or extending the preferences to all out-of-state companies. Enforcing the preferences as written on the books was not an option because of the risk of personal liability on the part of Department of Revenue personnel in enforcing provisions that were so clearly flawed in the wake of the Fulton decision.

One unconstitutional tax preference identified by the Revenue Laws Study Committee that is not addressed in this act is the 100% deduction allowed to North Carolina parent companies for subsidiary dividends received by them with no requirement that expenses be deducted from the tax-free income. Out-of-state parent companies are allowed an exclusion for subsidiary dividends but are required to adhere to the basic tax principle that expenses incurred to generate the tax-free dividend income cannot also be deducted. The Revenue Laws Study Committee recommended revising this preference to apply the basic tax principle to in-state parent companies. However, this provision is omitted from this act. Inaction on this item by the General Assembly will result in a revenue loss of approximately $3.5 million annually because the Department of Revenue will probably extend the current preference for in-state parents to out-of-state parents.

Part I of this act also extends the time a taxpayer has to challenge the unconstitutionality of most taxes from 30 days to one year, effective for taxes paid on or after November 1, 1996. The time limit remains at 30 days for excise taxes on alcoholic beverages, soft drinks, tobacco products, and controlled substances. In North Carolina, if a taxpayer believes a tax is unconstitutional, the taxpayer must pay the tax and contest the tax by requesting a refund within 30 days after paying the tax. This procedure is known as "paying under protest". The North Carolina Supreme Court has upheld the constitutionality of the State's 30-day rule and the United States Supreme Court, by deciding not to hear the case, upheld the State court's ruling.

States that require a taxpayer to contest a tax by paying under protest are called "postdeprivation remedy" states. Most postdeprivation remedy states have a statute of limitations that is longer than 30 days. The most common statute of limitations utilized by the postdeprivation remedy states is known as the "three-year/two-year" rule. Under this rule, in order for a taxpayer to recover a refund of money paid under a tax later declared to be illegal, the taxpayer must have filed for a refund within three years after the date that the taxpayer filed the return, or two years after the date the taxpayer paid the tax, whichever is later. South Carolina recently repealed its 30-day rule and replaced it with a three-year rule.

Finally, Part I of this act clarifies the tax treatment of refunds of unconstitutional taxes and other similar recoveries. Under Section 111 of the Code, if a taxpayer recovers an amount that the taxpayer had previously deducted, the taxpayer must add the amount of the recovery back to gross income. The typical example is a State income tax refund, which must be included in gross income if the taxpayer deducted it as an itemized deduction. The principle is that if the taxpayer received a tax benefit from deducting an expenditure, when the expenditure is refunded to or

recovered by the taxpayer, the taxpayer should give back the corresponding tax benefit. This adjustment normally carries through from the Code to North Carolina income tax statutes because North Carolina piggybacks the Code. In some situations, such as the alternative minimum tax, however, North Carolina does not piggyback the Code. A refund or recovery might represent a tax benefit under the Code but not North Carolina law, or vice versa. This part of the act provides consistency in requiring State add-backs of only those refunds and recoveries that represent State tax benefits. It prevents situations in which a taxpayer would receive a double deduction or be subject to double taxation because a refund (of an unconstitutional tax, for example) represented a tax benefit under the Code but not State law, or vice versa.

Sales and Use Tax

Part II of this act makes three changes to the State's sales and use tax laws, effective August 1, 1996:

(1) It enhances compliance and enforcement of existing sales and use tax laws by authorizing the Department of Revenue to enter into agreements to accept voluntary payments of State and local use tax and by directing the Department of Revenue to instruct mail-order companies to obtain the purchaser's county of residence for proper allocation of use tax revenue.

(2) It clarifies the sales tax treatment of items given away by merchants.

(3) It exempts from sales and use tax tangible personal property that is donated by a manufacturer or retailer to a nonprofit organization for a charitable purpose.

The State cannot require a mail-order marketer to collect and remit the use tax owed this State on sales to North Carolina residents unless the marketer has a store in North Carolina or other ties sufficient to give the State jurisdiction over it. If the direct marketer does business with North Carolina residents only through telephone, mail, and freight transactions, it does not have "nexus" with this State and is not required to collect the tax. The United States Supreme Court has held that states' efforts to require these out-of-state marketers to collect sales or use tax on sales to residents violate the interstate commerce clause of the United States Constitution.

As a result of these constitutional restrictions, out-of-state direct marketers have a competitive advantage over in-state merchants, and states lose significant amounts of revenue. Some direct marketers collect and remit use taxes voluntarily as a convenience to their customers. The Direct Marketers Association, the Federation of Tax Administrators, and the Multi-state Tax Commission are currently negotiating a possible agreement under which more direct marketers would voluntarily collect use tax on behalf of customers in states in which the marketers do not have nexus. Under this agreement, tax collection would be simplified by using the same form and payment deadlines in every state. In addition, the direct marketers would collect at only one rate per state; non-uniform county and city rates would be disregarded. If these parties are able to design a system that would be acceptable to all involved, North Carolina would need authority to enter into such an agreement. The act would provide that authority and set out some of the parameters for the agreement. If the ongoing negotiations result in a viable multi-state program for collection of use taxes by direct marketers and North Carolina enters into agreements pursuant to the program, the Department of Revenue could potentially collect millions of dollars in use taxes that are owed under current law but are not being paid.

The act also clarifies the sales tax treatment of items given away by merchants. It provides that property given away or otherwise used by a merchant is not exempt from use tax, except in the case of restaurants and caterers that give free meals to employees or free bar food to patrons and in the case of retailers that give a free item of inventory to a customer on the condition that the customer purchase similar or related property. As under former law, free books of matches would not be subject to use tax if they are given away along with the sale of cigarettes; matches given away where cigarettes are not sold would remain subject to use tax.

A general sales and use tax principle is that a wholesale merchant or retailer who gives away products free of charge instead of selling them is liable for use tax on the products. The use tax, first enacted in 1939, is the complement of the sales tax and applies to the storage, use, or consumption in this State of tangible personal property. A merchant is liable for the use tax on property it uses in its business, whether furniture, equipment, decor, or promotional giveaways. Items sold by a merchant, however, are not subject to use tax because sales tax will apply when the items are sold at retail.

There are some gray areas in determining whether a product is sold or is given away. For example, if a merchant has a "buy one, get one free" sale, both items are considered sold for the price of the first one. Although the second item appears to be given away, in fact both items are being sold at a discounted price. Another example is paper napkins, catsup, and other items that accompany and are consumed along with meals. These items are considered sold as part of the meal.

Until 1993, the following items were considered used, not sold, and thus subject to use tax: meals provided free to the merchant's employees, food given away to the merchant's patrons, and matches given away to patrons, other than matches given along with the sale of cigarettes. A group of restaurants appealed the assessment of this tax, claiming that in their case these items should be considered sold. The restaurants were selling meals to patrons and, at the same time, giving some of the food to employees as meals and some to patrons as "bar food" such as chips. In addition, free books of matches were provided to patrons for use in the restaurant.

The North Carolina Court of Appeals agreed with the restaurants that these items should be considered sold along with the food the restaurant sold as part of its business. In its opinion, the court reasoned that the cost of these items was recovered by the sale of other items. This rationale could arguably be applied in a very broad way to mean that the cost of all of a merchant's purchases should be exempt from sales and use tax because they are covered by the price of sold items; a merchant's profits from its sales generate the funds to purchase furniture, equipment, decorations, and other items. Thus, taken literally, the court ruling could be interpreted to eliminate the use tax altogether for merchants.

Finally, Part II of the act includes a new sales and use tax exemption for tangible personal property that is donated to a nonprofit organization by a retailer or a wholesale merchant. Under current law, medicine and certain food donated to a nonprofit organization to be used for a charitable purpose are exempt from sales and use tax. This act repeals these two exemptions since they become redundant in light of the new, and broader, exemption created by it.

Under current law, a wholesale merchant or retailer who donates products to a nonprofit organization instead of selling them is liable for the sales and use tax. A wholesale merchant or retailer does not pay sales or use taxes when purchasing the products or the ingredients used to

manufacture the products because the products are to be resold. Sales and use taxes do not apply to property purchased for resale or ingredients purchased to manufacture products for resale. If the wholesale merchant or retailer chooses not to sell the goods, the wholesale merchant or retailer becomes liable for use tax on the goods because the resale exemption no longer applies. This is true no matter what the company chooses to do with the products. The act eliminates this liability for use tax by providing a specific exemption for tangible personal property purchased or manufactured by a wholesale merchant or retailer for resale and then withdrawn from inventory and donated to a nonprofit organization, contributions to which are deductible as charitable contributions for federal income tax purposes.

Repeal of Most Privilege License Taxes

Part III of this act repeals most of the State privilege license taxes imposed under Article 2 of Chapter 105 of the General Statutes, effective July 1, 1997. This Part will reduce General Fund revenues by about $11 million a year. The only privilege taxes retained are the taxes imposed by G.S. 105-37.1 (amusements); 105-38 (circuses and similar shows); 105-41 (professionals); 105-83 (installment paper dealers); 105-88 (loan agencies or brokers); 105-102.3 (banks); and 105-102.6 (newsprint publications). The tax on professionals was retained because its repeal would reduce General Fund revenues by more than $3 million a year. The other taxes were retained because they have a gross receipts or other variable element (amusements, circuses, installment paper dealers, banks), are related to a tax that is retained (loan agencies), or were enacted for a regulatory purpose (newsprint publications).

The act preserves the status quo on privilege license taxation for cities and counties. Cities have general authority to impose privilege license taxes unless limited by Article 2; counties have no general authority to impose these taxes but are authorized by Article 2 to levy some specific taxes. The act provides that the current limitations and authorizations in Article 2 that apply to cities and counties will continue to apply. The act also preserves the itinerant merchant regulatory provisions but moves them to Chapter 66 of the General Statutes, Commerce and Business.

The Revenue Laws Study Committee found that the privilege license tax structure in Article 2 of Chapter 105 of the General Statutes is outmoded, inefficient, and not designed on proper principles of taxation such as tax fairness, ability to pay, responsiveness to growth, or administrative cost. There is no rationale for a tax on the privilege to work that applies only to a limited portion of businesses or the work force and that has a different and inconsistent tax rate for each different class of business. Because the tax is not indexed to any economic parameter, the cost to administer the tax has become increasingly high over time compared to the amount of tax collected. As a result, the tax has become more of a nuisance tax than a properly designed source of revenue for the State. The Revenue Laws Study Committee plans to study the elimination of the remaining State privilege license taxes and reform of the provisions governing local privilege license taxes.

Chapter 18, 1996 Second Extra Session (House Bill 53, Representative Holmes)

AN ACT TO MODIFY THE CONTINUATION BUDGET OPERATIONS

APPROPRIATIONS ACT OF 1995, AND THE EXPANSION AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 1995, AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATION OF THE STATE.

The Current Operations Appropriations Act of 1996 contains five tax law changes. It increases the property tax homestead exemption, modifies the State ports tax incentive, exempts milk drinks from the excise tax on soft drinks, allows the University of North Carolina Hospitals at Chapel Hill an annual refund of sales and use tax paid, and makes permanent the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council.

The act expands the homestead exemption amount from $15,000 to $20,000 and increases the income eligibility amount from $11,000 to $15,000, effective for taxes imposed for taxable years beginning on or after July 1, 1997. Under the act, the State will reimburse the counties and cities 50% of the loss they incur as a result of these tax law changes for two years. This reimbursement will cost the General Fund $3 million a year. The increase in the income eligibility amount will allow as many as 34,000 elderly and disabled homeowners to qualify for the homestead exemption who do not currently qualify. The increase in the homestead exemption amount will provide additional property tax relief to at least 155,000 elderly and disabled homeowners who currently qualify for the exemption.

The homestead exemption is a partial exemption from property taxes for the residence of a person who is either aged 65 or older or totally disabled and has an income of less than $11,000. The current exemption amount is $15,000. The exemption amount was last increased in 1993, when it was increased from $12,000 to $15,000. The income eligibility amount was last increased in 1987, when it was increased from $10,000 to $11,000. The income used to determine the income eligibility amount includes moneys received from every source other than gifts or inheritances received from a spouse, lineal ancestor, or lineal descendant. For married applicants residing with their spouses, the income of both spouses is included, whether or not the property is in both names.

The revenue loss associated with this act will be borne equally between the local governments and the State for the first two years. Prior to 1987, local governments absorbed most of the cost of the homestead exemption. From 1987 to 1991, the State reimbursed counties and cities for 50% of their losses from the homestead exemption. In 1991, the General Assembly froze the amount of reimbursements made to local governments to the amount each city and county was entitled to receive in 1991. That amount is approximately $7.9 million. No additional reimbursement was provided when the exemption amount was increased in 1993.

The act expands the State ports income tax credit to include the importing and exporting of forest products at the State-owned port terminal at Wilmington, effective for taxable years beginning on or after January 1, 1996. Forest products are a type of bulk cargo. Under current law, a taxpayer is not entitled to the income tax credit for bulk cargo imported or exported at the Wilmington terminal. This part of the act will reduce General Fund revenues by $180,000 for fiscal year 1996-97.

Bulk cargo is a type of commodity that is loose and usually stock-piled. Examples of this type of commodity include coal, grain, salt, and wood chips. Break-bulk cargo and container cargo are different methods used to ship the same type of commodity. Commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached

and put on a ship without any other handling are considered "container cargo". Commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc., are considered break-bulk cargo. Break-bulk cargo also includes machinery.

Under prior law, the income tax credit was available only for break-bulk cargo and container cargo imported or exported at the Wilmington terminal. The credit is available for bulk cargo, break-bulk cargo, and container cargo imported or exported at the Morehead City terminal. Since bulk cargo is generally imported and exported only at the Morehead City terminal, there has not been a need to extend the credit to this type of cargo at the Wilmington terminal. The credit is being narrowly extended to forest products because there is a customer at the Wilmington terminal who will be exporting wood chips and the Ports Authority believes all users of the Wilmington terminal should be entitled to the credit. The act does not extend the credit to all bulk products because the Wilmington terminal does not want to be seen as competing unfairly with other terminals located in the Wilmington area that import or export other types of bulk products.

The amount of the tax credit allowed is equal to the amount of charges paid to the North Carolina Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the past three years. The credit is limited to 50% of the tax imposed on the taxpayer for the current year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The cumulative credit may not exceed one million dollars per taxpayer. The credit will expire in 1998.

The act also removes the requirement that a flavored milk drink must be registered with the Department of Revenue before it can be exempt from the excise tax on soft drinks and extends the exemption to cover all soft drinks that contain milk. This part of the act is effective retroactively to October 1, 1991. The act does not result in a significant revenue loss because:

(1) Any assessments pending against a dairy that produces a flavored milk drink have not been paid and will not have to be paid under the provisions of this act.

(2) Other registered flavored milk drinks are currently exempt and therefore are not paying any tax.

Under prior law, a flavored milk drink containing at least 35% milk was exempt from the excise tax on soft drinks if it was registered with the Department of Revenue. Natural liquid milk produced by a farmer or a dairy has always been exempt from tax without the necessity of registering the milk product. The Department of Revenue assessed tax on some dairies' chocolate milk products because they were not registered with the Department. The dairies contested the assessments.

As originally introduced, this provision would have exempted from the registration requirement chocolate flavored milk produced by a dairy. This approach raised some legal concerns, however, because it resulted in similarly situated taxpayers being treated differently. For example, one flavored milk drink registered with the Department is produced by three different people: a dairy in North Carolina, a dairy located outside the State, and a packer in North Carolina. Under the original provision, the two dairies would not have to register the milk drink to receive the tax exemption and the packer would. To avoid possible litigation, this provision was revised to exempt all milk products from the tax. Under Chapter 13 of the 1995 Session Laws, 1996 Second Extra Session, the excise tax on all drinks will be repealed effective

July 1, 1999.

Fourthly, the Current Operations Appropriations Act of 1996 allows The University of North Carolina Hospitals at Chapel Hill to seek an annual refund of State and local sales and use tax they paid on direct purchases of tangible personal property. Sales and use tax liability indirectly incurred by the hospitals on building materials, supplies, fixtures, and equipment that become a part of or annexed to a building used by the hospitals is considered paid on a direct purchase by the hospitals. This part of the act becomes effective January 1, 1997, and applies to taxes paid on or after that date.

Under current law, nonprofit, private hospitals are allowed a semiannual refund of State and local sales and use taxes paid. For-profit hospitals are allowed a semiannual refund of State and local sales and use taxes paid on medicines and drugs. However, neither of these two refund provisions are applicable to hospitals owned or controlled by a governmental unit.

Under current law, local government agencies receive an annual refund of State and local sales taxes they pay but State agencies do not receive refunds of either State or local sales taxes. Local sales taxes paid by State agencies, including State-operated hospitals, are refunded quarterly to the General Fund rather than to the agency. State agencies do not receive refunds of State sales taxes because the appropriation of State funds for that agency includes the amount of sales tax payable by the agency.

As of the effective date of this act, the local sales taxes paid by the UNC hospitals will no longer be refunded to the General Fund and the State sales taxes paid by the UNC hospitals will no longer remain in the General Fund. These amounts will instead be paid directly to the UNC hospitals. Presumably, the appropriation to the UNC hospitals will be reduced to reflect this new refund.

This provision departs from the traditional policy that State sales taxes are not refunded to State-funded agencies. Refunding State sales taxes to agencies funded from the General Fund merely creates a loop of unnecessary administrative costs and paperwork as funds are paid into the General Fund as sales taxes then refunded by the Department of Revenue out of the General Fund. In all other cases, the same result is reached without the paperwork by including in the agency's General Fund appropriation an amount to cover the sales taxes paid into the General Fund. The latter approach saves the Department of Revenue and the State agency the administrative costs associated with periodic refunds.

This refund applies only to the UNC hospitals and not to other State hospitals and similar facilities. As well as the UNC hospitals, the State operates four psychiatric hospitals: Dorothea Dix Hospital, Broughton Hospital, Cherry Hospital, and John Umstead Hospital. In addition, the State operates various Alcohol and Drug Treatment Centers and Mental Retardation Centers around the State. These centers are in-patient facilities similar to hospitals. In the case of all State-operated hospitals and treatment centers other than the UNC hospitals, the General Assembly appropriates money from the General Fund to pay for sales taxes, rather than reducing the institution's appropriation and requiring the institution and the Department of Revenue to process refunds.

Lastly, the act makes permanent a quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council. Under G.S. 105-113.81A, 94% of the net proceeds of the excise tax collected on unfortified wine bottled in North Carolina during the

previous quarter and 95% of the net proceeds of the excise tax collected on fortified wine bottled in North Carolina during the previous quarter is credited to the Department of Agriculture. The amount credited may not exceed $90,000 per fiscal year; any funds credited to the Department under this statute that are not expended during the fiscal year do not revert to the General Fund at the end of a fiscal year. The Department of Agriculture allocates these funds to the North Carolina Grape Growers Council to be used to promote the North Carolina grape and wine industry and to contract for research and development services to improve viticultural and enological practices in North Carolina.

This distribution has been in effect since 1987. Under the original legislation, the distribution would have terminated on June 30, 1997, and the funds would have been credited to the General Fund. This part of the act removes the sunset.

In 1973, the General Assembly enacted legislation providing that the tax on wine manufactured in North Carolina would be lower than the tax on other wines. In 1984, the United States Supreme Court decided in the Bacchus case that an unequal tax between in-state and out-of-state wine violated the Commerce Clause of the United States Constitution. As a result of this decision, the State and the local governments, who receive a percentage of the excise tax on wine, realized a revenue increase. In 1987, the General Assembly decided that a portion of this increased revenue should be used to promote and improve the State's grape and wine industry. This part of the act continues this philosophy.

In 1985, the General Assembly enacted an income tax credit for distributing North Carolina wine. Chapter 14 of the 1996 Second Extra Session repealed this credit because it had the same flaw as the intangibles tax stock deduction that was declared unconstitutional by the United States Supreme Court in the Fulton decision. The United States Supreme Court ruled that the intangibles tax stock deduction violated the interstate commerce clause of the federal constitution.

Chapter 19, 1996 Second Extra Session (House Bill 30, Representative Grady)

AN ACT TO REFUND TO FEDERAL RETIREES THE UNCONSTITUTIONAL TAXES THEY PAID ON THEIR PENSIONS FOR TAX YEARS 1985 THROUGH 1988.

This act gives federal retirees income tax credits and partial refunds for the North Carolina income taxes they paid on their federal retirement benefits in 1985, 1986, 1987, and 1988. These credits and refunds will cost the General Fund more than $117 million over three years. The amount a federal retiree may claim as a credit or refund is reduced by any amounts previously credited or refunded to the federal retiree for the same pension taxes. If a federal retiree paid the 1985-88 pension taxes under timely protest, the retiree already received a refund as required by existing law. Under this act, federal retirees who did not make a timely protest and who pay North Carolina income tax may take a State income tax credit in three equal installments beginning with the 1996 tax year. For a taxpayer whose 1996 tax liability is less than 5% of the tax the taxpayer paid on federal retirement benefits during 1985-88, a one-time refund is allowed in lieu of a credit. The taxpayer must claim this refund by April 1, 1997. The refund allowed is the lesser of 85% of the amount claimed or a reduced amount. The reduced amount occurs when the total refunds claimed exceed the $25 million the General Assembly has set aside to pay for the

refunds. If the $25 million cap is reached, then the refunds are prorated based on the amount each taxpayer claimed. If a federal retiree who would otherwise be eligible for a credit or refund has died, the retiree's estate may claim the credit or refund.

In 1990, the General Assembly gave to federal retirees who had not made a timely protest an income tax credit for the amount of tax paid on their federal retirement benefits in 1988. This tax credit was not refundable and was not allowed to deceased federal retirees; it was allowed in three installments. This credit was granted as a result of the 1989 United States Supreme Court decision in Davis v. Michigan, which held that the doctrine of intergovernmental tax immunity prohibits a state from taxing federal retirement income at a higher rate than State retirement income. Prior to 1989, North Carolina allowed a full income tax exclusion for State retirement income and a $3,000 annual exclusion for federal retirement income; there was no exclusion for private pension income. To comply with the Davis decision, the General Assembly in 1989 allowed all government retirees (state, local, and federal) a $4,000 annual exclusion. At the same time, it allowed private retirees a $2,000 annual exclusion.

The tax credit for 1988 taxes was enacted in 1990 to equalize the treatment of those who paid under protest for 1988 and those who did not. The Davis decision was issued on March 28, 1989, the middle of the income tax filing period for the 1988 tax year. Those taxpayers who learned about the Davis decision in time paid under protest within the 30-day time limit prescribed by law or refused to pay tax on their federal retirement benefits. Those who had paid their taxes early or did not become aware of the Davis decision until later were not able to make a timely protest.

The State currently faces similar constitutional challenges to several of its other taxes. The United States Supreme Court declared North Carolina's intangibles tax on stocks unconstitutional in the 1996 Fulton decision. Other taxes that were collected until their repeal in the 1996 tax year, such as the individual income tax credit for North Carolina dividends and the corporate income tax deduction for North Carolina dividends, have been identified by the Revenue Laws Study Committee as having the same constitutional flaw as the intangibles tax. Furthermore, State, local, and federal retirees are currently challenging the constitutionality of the income tax levied on their pensions for the tax years from 1989 to the present. Taxpayers who paid the intangibles tax and other unconstitutional taxes without filing a timely protest will likely seek legislation granting them refunds of three years' back taxes, relief similar to that granted federal retirees by this act. The cost of granting relief to other taxpayers in the same position as the federal retirees aided by this act could cost the General Fund hundreds of millions of dollars.

1996 Regular Session

Chapter 560 (House Bill 1119, Rep. Shaw)

AN ACT TO DELETE THE REQUIREMENT THAT A COMPANY ADD BACK TO ITS NET WORTH FRANCHISE TAX BASE THE AMOUNT OF ITS LOANS THAT ARE PAYABLE TO AN UNRELATED COMPANY BUT ARE ENDORSED OR GUARANTEED BY A RELATED COMPANY, AS RECOMMENDED BY THE

DEPARTMENT OF REVENUE.

This act deletes a provision in the corporate franchise tax laws that requires a parent, a subsidiary, or an affiliate of another corporation to include in its franchise tax base the amount of any debt that is owed by the corporation and is endorsed or guaranteed by one of its related corporations. The change is effective for taxable years beginning on or after October 1, 1996. The change is made at the recommendation of the Department of Revenue and is expected to have a revenue loss of no more than $10,000 a year.

Under current law, a corporation that is a parent, a subsidiary, or an affiliate of another corporation is required to add back to its net worth franchise tax base the amount of any debt it has that is payable to its parent, affiliate, or subsidiary or is endorsed or guaranteed by its parent, affiliate, or subsidiary. Debt that is not payable to a parent, affiliate, or subsidiary and is not guaranteed by one of these corporations is not required to be added back to the base. The act deletes the requirement that debt endorsed or guaranteed by a related company be added back and retains the requirement that debt payable to a related company be added back.

The Department of Revenue recommended this change because of the difficulty of enforcing the endorsement provision and the lack of need for the requirement. The existence of endorsed or guaranteed debt is often not readily ascertainable from the financial statements of a corporation. When a corporation endorses or guarantees a debt, it makes no accounting entry, such as the creation of a liability, to acknowledge the endorsement or guarantee. If the amount of debt endorsed or guaranteed is significant, the existence of the debt will be reflected in a footnote of the financial statements.

The franchise tax is a tax on corporations for the right or privilege to exist as a corporate entity and, in the case of foreign corporations, the right or privilege to do business in a corporate capacity in North Carolina. The tax is levied on the assets of a corporation. The tax rate is $1.50 per $1,000 with a minimum of $35. The franchise tax base on which the tax is computed is the largest of the following:

(1) Capital stock, surplus, and undivided profits.
(2) 55% of appraised property tax value of all taxable personal property
(3) The corporation's actual investment in tangible property in North Carolina.

The add-back requirement is imposed to prevent related companies from understating their net worth through means of transactions with each other. A corporation can make capital available to another corporation in several ways. For example, it can buy the corporation's stock or loan the corporation money. The stock purchase would be reflected in the net worth of the company but the debt would be a deduction in computing net worth. To establish the economic reality between the companies, the loan is required to be added back so that it is in effect treated the same as the stock purchase.

Under current law, endorsed or guaranteed debt is required to be added back also even though the corporation making the endorsement or guarantee did not decrease its capital to increase that of the corporation receiving the loan. Endorsed or guaranteed debt is more like third-party debt than a loan from one company to another.

A recommendation of the Revenue Laws Study Committee.

Chapter 590 (House Bill 540, Rep. Connie Wilson)

AN ACT TO AUTHORIZE THE ISSUANCE OF NINE HUNDRED FIFTY MILLION DOLLARS GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, FOR THE CONSTRUCTION OF HIGHWAYS AND TO AMEND THE HIGHWAY TRUST FUND.

This act authorizes the issuance of $950 million of highway bonds if approved by the voters in November 1996. Of the $950 million, $500 million is for the urban loop projects of the Highway Trust Fund, $300 million is for the Intrastate System projects, and $150 million is for paving secondary roads in the State highway system. The bonds would be repaid from Highway Trust Fund revenue allocated for the Trust Fund urban loops, the Intrastate system, and secondary road construction. The State last issued highway bonds in 1977; the amount of the bonds was $300 million. These bonds have been refinanced since 1977 but will be repaid at the end of 1997.

The bonds authorized by the act are State general obligation bonds. The State therefore pledges its taxing power to repay the bonds. The bonds must mature no later than December 1, 2013, the projected date for completion of all the Highway Trust Fund projects.

If issued, the revenue from the bonds would be appropriated to the Department of Transportation. $500 million would be used for urban loops around the following seven cities: Asheville, Charlotte, Durham, Greensboro, Raleigh, Wilmington, and Winston-Salem. $300 million would be used for the Intrastate System projects listed in G.S. 136-179. The remaining $150 million would be used to pave unpaved secondary roads on the basis of percentage of unpaved miles.

Revenue in the Highway Trust Fund is allocated as follows: 61.95% for Intrastate System Projects (these 32 projects are listed in the statutes); 25.05% for the seven designated urban loops; 6.5% for city streets; and 6.5%, plus $15.00 of the $35 title fee, for secondary roads. The $500 million in bonds for urban loops would be repaid from the 25.05% allocation for urban loops, the $300 million for Intrastate System projects would be repaid from the 61.95% allocation for these projects, and the $100 million in bonds for secondary roads would be repaid from the 6.5% allocation for secondary roads.

Additional funds could be applied to the Trust Fund urban loops without issuing bonds. Since the Trust Fund was established in October of 1989, the Department of Transportation has transferred $862.9 million from the Trust Fund to the Highway Fund for use on non-Trust Fund projects. This figure is 66.6% of the $1.29 billion Trust Fund revenue collected. If more revenue is applied to Trust Fund projects, less revenue would be applied to non-Trust Fund projects in the Transportation Improvement Program.

The Department of Transportation is almost exactly on schedule with the paving of secondary roads under the Trust Fund plan. Secondary roads are funded from both the Highway Fund and the Highway Trust Fund. An amount equal to 1 3/4 ¢ of the motor fuel tax is allocated for secondary roads from the Highway Fund and is distributed on the basis of the percentage of unpaved secondary roads in each county. Of the Trust Fund supplement, $68,670,000 is allocated annually on the basis of vehicular traffic and the rest on the percentage of unpaved secondary roads.

Chapter 631 (House Bill 1100, Rep. Daughtry)

AN ACT TO IMPLEMENT THE RECOMMENDATION OF THE SCHOOL CAPITAL CONSTRUCTION STUDY COMMISSION TO AUTHORIZE THE ISSUANCE OF GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, TO PROVIDE FUNDS FOR GRANTS TO COUNTIES FOR PUBLIC SCHOOL CAPITAL OUTLAY PROJECTS, IN ORDER TO PROMOTE EQUITY IN LOCAL SCHOOL FACILITIES ACROSS THE STATE AND TO ENABLE LOCAL GOVERNMENTS TO GIVE LOCAL PROPERTY TAX RELIEF, AND TO ENSURE THAT CERTAIN GRANTS FOR SCHOOL FACILITY NEEDS CONTINUE TO BE MADE IN ACCORDANCE WITH THE 1988 PRIORITY LIST.

This act authorizes the issuance of $1.8 billion of State public school bonds if approved by the voters in November 1996. It addresses the $6.2 billion backlog of school capital needs in this State that were identified by a needs assessment prepared for the General Assembly's School Capital Construction Study Commission. Of the $1.8 billion in bond proceeds, $30 million would be set aside for grants to small county school systems and the remaining $1.77 billion would be allocated on the basis of three different methods: 40% would be allocated to counties on the basis of average daily membership; 35% would be allocated on the basis of low wealth; and 25% would be allocated on the basis of high growth.

The State Board of Education would determine which of the small county school systems could receive a grant from the $30 million set aside for small school systems. A small county school system is one that was entitled to receive small school system supplemental funding under section 17.2 of Chapter 507 of the 1995 Session Laws, The Expansion and Capital Improvements Act of 1995. A county that receives a grant from the $30 million set aside does not have to match the allocation.

Counties would be required to match the allocations from the remaining $1.77 billion of bond revenue. The amount of the match is based on average daily membership and high growth. The required match is 3¢ times the county's 1995-96 ability to pay rank for each $1.00 of bond proceeds to be received under those allocations. This rank has been determined by the State Board of Education. Public school capital expenditures and the face amount of debt authorized or incurred for public school capital purposes since January 1, 1992, qualify for the match. With respect to debt authorized or incurred for public school facilities before January 1, 1992, amounts expended on or after January 1, 1992, for debt service for the debt qualify for the match. Any allocated funds that are not matched as required by January 1, 2003, will be redistributed among the counties that met the matching requirements.

The proceeds of the bonds must be used to construct or improve public school buildings, buy equipment needed for the newly constructed or improved school buildings, or buy land needed for the construction or improvement of the school buildings The facilitates financed by the proceeds must be used for instructional and related purposes and cannot be used for centralized administration facilities, maintenance facilities, trailers, relocatable classrooms, or mobile classrooms.

The bonds authorized by the act are State general obligation bonds. This means that the State pledges its taxing power in payment of the bonds. If issued, the debt service on the bonds

would be one of the items to be paid by the State from its general revenues. The act prohibits the State Treasurer from issuing more than $450 million of the bonds in any twelve-month period. The debt service costs of State general obligation bonds, including the $1.8 billion of school bonds proposed by this act, will be less than 2.5% of General Fund revenues. The debt service payments incurred due to the issuance of bonds or notes under this act are removed from any applicable General Fund spending limit.

The act also dissolves The Commission on School Facility Needs, specifies that the last 11 local school administrative units on the priority list established in 1988 by the Commission shall be funded from the Critical School Facility Needs Fund, and repeals the Fund 30 days after the last of those 11 projects are funded.

A recommendation of the School Capital Construction Study Committee.

Chapter 646 (Senate Bill 1178, Sen. Cochrane)

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES AND TO ALLOW THE VOLUNTARY WITHHOLDING OF INCOME TAX FROM UNEMPLOYMENT COMPENSATION PAYMENTS.

This act makes numerous technical and clarifying changes to the revenue laws and related statutes. It also amends North Carolina's unemployment compensation law to allow the voluntary deducting and withholding of federal and State income taxes in accordance with federal law. The following table provides a section-by-section analysis of the proposed changes.

Section	Explanation
1	Adds a caption to this subsection. The other subsections of this statute all hav captions.
2	Returns to the statute words that were inadvertently deleted in 1995.
3	Repeals two obsolete statutes, imposing franchise taxes on pullman, sleeping, chai and dining cars, and on express companies. Railroads pay general franchise and incom taxes. There are no longer any express companies; if there were, they would pay th general franchise and income taxes.
4	Returns the term "held" to the statute. In 1995, this sales tax exemption was revise to clarify that aquaculture is covered. The statute applies to animals or plants produce or held for commercial purposes; the 1995 rewrite accidentally removed "held".
5	Repeals a provision that grants a sales tax exemption for works of art purchase pursuant to the art in State buildings program of Article 47A of Chapter 143B of th General Statutes. Because that program has been repealed, the sales tax exemption is n longer needed.
6	Corrects an incorrect citation.
7,8	Repeals obsolete administrative provisions in the gift tax provisions. Thes provisions have been superseded by Article 9 of Chapter 105 of the General Statute Article 9 of Chapter 105 contains the administrative provisions that apply to all taxe administered by the Secretary under that Chapter.

9 Repeals the penalty of $10 a day for failure to file a privilege license tax return o franchise tax return, which is obsolete and redundant. The general penalties that appl to all taxes already apply to these taxes.

10 Allows the Secretary of Revenue to assess a negligence penalty for reportin improper adjustments to federal taxable income to the same extent as for understatin gross income or overstating deductions. In cases of substantial income tax deficiencies, 25% penalty is assessed if the deficiency was caused by understating gross income or b overstating deductions, both of which are determined on the federal return. The penalt provisions do not address deficiencies caused by improper adjustments to federal taxabl income: adjustments that are made at the State level to determine North Carolina taxabl income. This section provides that the same penalty applies whether the deficienc resulted from understating gross income, overstating deductions, or misstatin adjustments. This section also repeals references to "this subchapter," which are obsolet The term "tax" is now defined to include not only taxes under Subchapter I of Chapte 105 of the General Statutes but also taxes under Subchapters V and VIII and inspectio taxes levied under Article 3 of Chapter 119 of the General Statutes. Finally, this sectio corrects spelling errors and modernizes the language of the statute.

11 Reinstates an extended period of time for making assessments for income tax du attributable to gains from involuntary conversions or from the sale of a princip residence parallel to federal law. The extension is necessary because the law allows th taxpayer a period of time to replace the converted property or the principal residenc with similar property and thereby avoid recognition of the gain. If the taxpayer fails t replace the property, gain is recognized and the assessment may be made within thre years after the Secretary is notified that the requirements for nonrecognition will not b met. Before 1989, North Carolina's individual income tax contained a similar provisio when the tax law was rewritten to "piggyback" the federal internal revenue code, tha provision was inadvertently not picked up.

12 Corrects a citation. The federal statute to which this language refers has bee renumbered.

13, 14 Effective July 1, 1996, revises the split inventory tax reimbursement date from a August/April date to a September/April date and changes the 60%/40% split to 50%/50% split. 1995-96 will be the only year in which the 60/40 August/April spli reimbursement occurred. Because these sections become effective July 1, 1996, changin the 1995 languages does not affect the validity of what is being done in 1995-96.

15 Corrects an incorrect cross-reference.

16 Exempts certain property owners from filing annual applications for property ta exemptions. According to the Institute of Government, by administrative practic annual applications are not required for exempt property of veterans' organization Masonic lodges and shrines, elks and similar fraternal organizations, or disable veterans. In addition, the Institute of Government suggests that there is no reason t require annual applications for exemption of pollution control and recycling equipmen because the exemption is automatic once the Department of Environment, Health, an Natural Resources determines that the equipment qualifies.

17 Corrects an inadvertent expansion of the use value law. Legislation enacted in 199 codified existing interpretations of the use value law that allow a partner in a partnershi or a member of a limited liability company to treat their share of land owned by th entity as if they owned it directly. The legislation inadvertently include corporate-owned land under the same rule.

18 Removes redundant language that renders certain definitions circular. This sectio also modernizes the form in which the definitions are set out.

19 Restores omitted reference. Until 1995, funds in the Insurance Regulatory Fun could be used only to reimburse the General Fund for the Department of Insurance' expenses in regulating the insurance industry and other industries in this State. Th statute was expanded in 1995 to include expenses of other State agencies in regulatin the insurance industry and in carrying out certain duties under the Medical Care Dat Act. The 1995 rewrite inadvertently omitted reference to other industries, in addition t insurance, that the Department of Insurance regulates. For example, the Departmen regulates bail bondsmen and collection agencies.

20 Removes an unnecessary reference to an effective date.

21 Existing law provides that certain local tax records are not public records; this sectio clarifies the corresponding provision under the Public Records Act.

22 Relocates a provision in the consolidated city-county act to the appropriate statut The provision applies to all urban service districts but is currently located in a statut that applies only to certain urban service districts. A consolidated city-county is a count in which the largest municipality has been abolished and its powers, duties, right privileges, and immunities have been consolidated with those of the county. Othe municipalities may also be abolished and consolidated with the county. A consolidate city-county may define urban service districts to finance services within the county at higher level than in other areas of the county. These urban service districts may replac municipalities that have been abolished or may be created to serve areas that hav population density, property valuation, and needs that justify a higher level of service than is provided in the county generally.

23 Amends existing local acts establishing beautification districts to clarify that th districts are special districts established under Article VII of the North Carolin Constitution and not special tax areas governed by Section 2(4) of Article V of the Nort Carolina Constitution. The constitution permits local acts establishing special ta districts but not local acts establishing special tax areas. The following local act authorize beautification districts:

(1) Dare County, Duck District: SL83-991, SL93-610, and SL95-303.
(2) Dare County, Outer Banks District: SL89-363.
(3) Currituck County, Currituck Outer Banks District: SL89-400 an SL95-446. The former citation appears to be obsolete.
(4) Currituck County, Coinjock Canals District: SL89-703.
(5) Cabarrus County, Poplar Tent: SL91-685.

24 Clarifies the valuation date to be used for vehicles registered for property taxe under the annual system. In 1995, the General Assembly amended the law concernin

the valuation of motor vehicles to eliminate the problem of the correct valuation dat when an owner with a registration that expires December 31 renews during the Januar grace period. In eliminating the problem for vehicles registered on a staggered syste the amendment created a problem for those registered on an annual system. In the latte case, it may result in the same valuation being used for two years. This act corrects thi problem.

25 Amends North Carolina's unemployment compensation law to allow the voluntar deducting and withholding of federal and State income taxes in accordance with feder law. If an individual elects to have federal income tax withheld, then 15% of th payment will be withheld for federal income tax purposes. Fifteen percent is the lowes tax bracket at the federal level. If an individual elects to have State income tax withhel then the individual may determine the amount to be withheld. This provision follow the general rule for voluntary withholdings of State individual income tax in G. 105-163.3(g). Although unemployment compensation has always been subject to incom tax, the deducting and withholding of income tax from unemployment compensatio payments has not been allowed because of the restrictive nature of the Unemploymen Trust Fund. Congress enacted legislation to allow voluntary deducting and withholdin of federal and state income taxes from the payments, effective for payments made on o after January 1, 1997.

26 Effective date.

Chapter 647 (Senate Bill 1198, Sen. Kerr)

AN ACT TO CLARIFY THE REQUIREMENTS CONCERNING IMPORTS AND EXPORTS OF MOTOR FUEL UNDER THE "TAX AT THE RACK" LAWS AND TO MAKE OTHER ADJUSTMENTS TO THOSE LAWS.

This act adjusts the motor fuel tax collection system, known as "tax at the rack," that was enacted by the General Assembly in the 1995 Session and became effective January 1, 1996. To date, the 1995 legislation has increased motor fuel tax revenues as predicted. If collections continue at the same level for the remainder of the year, motor fuel tax revenue will increase by about $27 million dollars. The changes made by this act primarily clarify the tax treatment of exports, imports, blended fuel, and the inspection tax on kerosene and fill in gaps discovered in implementing the new law.

Imports: The act makes it clear that a separate importer license is not required if a person is licensed as a distributor and buys motor fuel for import only from an out-of-state supplier that collects the North Carolina tax. These tax-collecting suppliers are known as elective or permissive suppliers. Current law appears to require all importers to have an importer license regardless of other licenses they may have. The act also makes it clear that an importer that buys from an elective or permissive supplier is entitled to the same discount and "float" as if the fuel had been purchased inside the State.

Exports: The act makes it clear that an exporter is not required to have a license and treats licensed exporters differently than unlicensed exporters. An unlicensed exporter must pay tax to North Carolina at the North Carolina rate of tax and then apply for a refund when the fuel is

resold out-of-state. A licensed exporter can pay tax at the rate of the destination state of the fuel, thereby eliminating the need for a refund. If exported fuel is to be sold for an exempt use in the destination state, the licensed exporter can buy the fuel tax-free until July 1, 1997, when this privilege sunsets.

Blended Fuel: The act makes it clear that the tax due on fuel-grade ethanol is payable by the supplier of that fuel rather than by the person who buys it and makes the blend of ethanol and gasoline. This ensures that the tax is collected at the highest point in the distribution chain and parallels the collection of the tax on gasoline. The act also requires a blender to post a bond if the blender's average expected annual tax liability is at least $2,000. Prior law required a bond from blenders, so this change reinstates the requirement in a modified form.

Kerosene Inspection Tax: The act sets the due date for payment of the kerosene inspection tax at the date set for payment of motor fuel taxes and eliminates the need for most kerosene distributors to be licensed. It eliminates the need for a license for those distributors that buy kerosene only from in-State suppliers or from elective or permissive out-of-State suppliers. The license is not needed because the kerosene inspection tax is collected by suppliers at the rack along with the motor fuel tax. A kerosene distributor can choose to be licensed and get the payment deferral and float. The only kerosene distributors that must continue to be licensed are airlines that have spur pipelines for kerosene.

Other Changes: The act makes several other changes to the penalty and reporting provisions and adds a tax on unauthorized behind-the-rack transfers to parallel federal law. The penalty changes impose liability on a person who accepts delivery of motor fuel when the shipping document for the fuel shows a different destination state for the fuel. It adds as a Class 1 misdemeanor the failure of a supplier to give a distributor the deferred payment and float. It adds a civil penalty for refusing to allow a sample of motor fuel to be taken, for a terminal operator that has unaccounted for motor fuel losses, and for failure to file a motor fuel informational return.

A recommendation of the Revenue Laws Study Committee.

Chapter 649 (Senate Bill 1239, Sen. Cooper)

AN ACT TO EXEMPT FROM SALES AND USE TAX FREE SAMPLES OF PRESCRIPTION DRUGS DISTRIBUTED BY THE MANUFACTURER.

This act creates a new sales and use tax exemption for prescription drugs that are distributed free of charge by the manufacturer. The sale of drugs bought with a prescription has been exempt from sales tax since 1937. The act defines the term "prescription drug" to be a drug that under federal law is required, prior to being dispensed or delivered, to be labeled with the following statement: "Caution: Federal law prohibits dispensing without prescription." This is the same definition used for the term in the Pharmacy Practice Act, G.S. 90-85.3. The act became effective upon ratification, June 21, 1996. The revenue loss to the General Fund is expected to be less than $400,000 a year.

Pharmaceutical companies often distribute free samples of prescription drugs to physicians to give to their patients. The prescription drugs that are distributed by free samples to the physicians are generally prescribed by them to their patients. Although the prescribed drugs are exempt from sales tax, the Department of Revenue has assessed use tax on the free samples.

The use tax, first enacted in 1939, is the complement of the State's sales tax and is imposed on the storage, use, or consumption in this State of tangible personal property. A pharmaceutical manufacturer is not liable for sales or use taxes when it purchases the ingredients used to manufacture the prescription drugs because the products are to be resold. However, when the manufacturer chooses to give the drug samples away rather than sell them, the Department has held the manufacturer liable for the use tax on the drugs.

Last year, Abana Pharmaceuticals, Inc. appealed an assessment of use tax on free samples of prescription drugs distributed to North Carolina physicians. The Tax Review Board reversed the decision of the Assistant Secretary for Legal and Administrative Services and concluded, based on the sales tax exemption for prescription drugs, that the free samples of prescription drugs distributed to physicians are exempt from use tax. The Department is appealing the Tax Review Board's decision. This act exempts the free samples from use tax prospectively. If the Court upholds the Board's decision, then the exemption will apply retroactively to Abana Pharmaceuticals, Inc., and arguably to all other similarly situated pharmaceutical companies.

The free distribution of prescription drugs by physicians is not subject to tax because the taxable use of the samples occurred prior to their distribution by the physician when the manufacturer provided the drugs to its salespersons. Hospitals and other purchasers of drugs without a prescription will still be subject to the sales and use tax. Nonprofit hospitals are entitled to a refund of any sales and use taxes paid under G.S. 105-164.14(b).

Chapter 664 (House Bill 1147; Rep. Shubert)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS.

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1995, to March 20, 1996. This change makes Code changes made during this period effective for any State taxes that are tied to the affected parts of the Code. The impact on the General Fund is expected to be insignificant.

Only four changes were made in the Code from January 1, 1995, until March 20, 1996. The first three of these were made in The Self-Employed Health Insurance Act (Public Law 104-7 (H.R. 831), enacted in 1995, and the last one was part of legislation enacted on March 20, 1996:

(1) The individual income tax deduction for health insurance premiums paid by self-employed individuals was reinstated and made permanent. This includes premiums paid on behalf of the self-employed individual, a spouse, and dependents. The deduction is 30% of the qualifying premiums.

(2) Code section 1033 was amended to make C corporations and certain partnerships ineligible to defer gain on an involuntary conversion under that section when replacement property is purchased from a related person. The change was effective for acquisitions after February 5, 1995.

(3) Code section 1071 was repealed effective for sales or exchanges after January 16, 1995. That section allowed a taxpayer to treat the sale of a broadcast property as an involuntary conversion if the sale was certified by the FCC as necessary to effectuate an FCC ownership and control policy.

(4) The Code was amended to increase the amount of military pay that is exempt from income tax for certain commissioned officers serving in the peacekeeping efforts in Bosnia and Herzegovina, known as Operation Joint Endeavor, and to exclude exempt military pay from withholding requirements.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to the question lies in both a policy decision and a potential legal restraint.

First, the policy reason for specifying a particular date is that, in light of the many changes made in federal tax law from year to year, the State may not want to adopt automatically federal changes, particularly when these changes result in large revenue losses. By pinning references to the Code to a certain date, the State ensures that it can examine any federal changes before making the changes effective for the State.

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, § 2(1) of the Constitution provides in pertinent part that the "power of taxation... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would... be invalidated as an unconstitutional delegation of legislative power."

A recommendation of the Revenue Laws Study Committee.

Chapter 691 (Senate Bill 1179, Sen. Kerr)

AN ACT TO PROVIDE A GRACE PERIOD FOR MILITARY PERSONNEL TO LIST AND PAY PROPERTY TAXES AFTER DEPLOYMENT IN CONNECTION WITH OPERATION JOINT ENDEAVOR.

This act gives military personnel deployed in the peacekeeping effort in Bosnia and Herzegovina, known as Operation Joint Endeavor, 90 days after the end of their deployment to pay their 1995-96 or later property taxes without interest and to list property for the 1996-97 tax year or a later tax year. The act applies to those serving in or in support of the armed forces and armed forces reserves, including the national guard. Deployment of military personnel pursuant to Operation Joint Endeavor began December 4, 1995. Approximately two-thirds of the 25,000 military personnel deployed in Operation Joint Endeavor are from North Carolina bases.

Property taxes for the 1995-96 fiscal year would otherwise become delinquent if not paid by January 6, 1996, and interest would accrue at the rate of 2% for the first month and 3/4% each month thereafter. The regular listing period for property taxes for the 1996-97 year ended on January 31, 1996. Failure to list is punishable as a misdemeanor and also subjects the owner of the property to a tax penalty equal to 10% of the tax due on the property. Automobiles are taxed

on a staggered, year-round schedule, so the listing date and the date the taxes become delinquent may fall at any time during the year.

The act is effective retroactively as of December 4, 1995. Any interest and penalties assessed before it is enacted would be refunded.

G.S. 105-249.2 and G.S. 105-158 already provide income tax extensions for military personnel serving in a combat zone and income tax forgiveness for personnel who are killed while serving in a combat zone, to the same extent as federal law (sections 7508 and 692 of the Internal Revenue Code). Our Department of Revenue will automatically follow the federal law. Congress has enacted Public Law 104-117 providing that these sections of the Code apply to personnel deployed in connection with Operation Joint Endeavor.

A recommendation of the Revenue Laws Study Committee.

Chapter 696 (House Bill 1094, Rep. Cansler)

AN ACT TO PROHIBIT THE IMPOSITION OF A FAILURE TO PAY PENALTY WHEN ADDITIONAL TAX DUE IS PAID AT THE TIME AN AMENDED RETURN IS FILED OR WITHIN THIRTY DAYS AFTER THE ADDITIONAL TAX WAS ASSESSED.

This act prohibits the imposition of a tax penalty for failure to pay in two circumstances. The first circumstance is when an additional tax is due with an amended return. The second circumstance is when a tax assessed by the Secretary of Revenue is paid within 30 days after it was assessed. The changes become effective for taxes due on or after January 1, 1997. The act should decrease General Fund revenues by no more than $100,000 a year.

The failure to pay penalty is 10% of the amount due, with a minimum penalty of $5.00. The Secretary of Revenue has the authority under G.S. 105-237 to waive the penalty. The decision of whether or not to waive a penalty is made on a case by case basis.

Currently, G.S. 105-236(4) requires the failure to pay penalty to be assessed whenever a tax is not paid when it was due. The due date for additional tax owed on an amended return is considered to be the date the original return was due. Consequently, any time a taxpayer files an amended return and pays additional tax with the return, the taxpayer is assessed the failure to pay penalty. Similarly, the due date for a tax assessed by the Secretary is considered to be the date the tax should have been paid without resort to an assessment. Consequently, any time a taxpayer is assessed for unpaid taxes, the taxpayer is also assessed the failure to pay penalty.

The changes made by this act make the "trigger" for the State failure to pay penalty the same as under federal law. A federal failure to pay penalty is not assessed when additional tax shown on an amended return is paid when the return is filed nor when a tax assessed by the Internal Revenue Service is paid within 10 days after the date on the notice of assessment and demand for payment. The penalty is not assessed under either federal or State law if a return is filed after an extension has been granted and the amount of tax paid when the extension was granted is at least 90% of the amount shown on the return.

In discussing this issue, the Revenue Laws Study Committee concluded that applying a failure to pay penalty to additional tax that is shown due on an amended return and is paid with the return discourages the filing of an amended return and does not make any allowance for reporting errors on tax reporting statements such as 1099 forms issued by banks and brokerage houses and W-2 forms issued by employers that result in the need for an amended return. The

Committee further concluded that allowing a grace period after a tax is assessed before applying a failure to pay penalty would encourage prompt payment of the assessed taxes. Finally, the Committee concluded that applying a State failure to pay penalty in the circumstances described when no federal penalty applies is unnecessarily confusing and makes the State law on this topic harsher than the federal.

A recommendation of the Revenue Laws Study Committee.

Chapter 741 (Senate Bill 1165, Sen. Kerr)

AN ACT TO ALLOW COUNTIES TO REMOVE VEHICLE REGISTRATION TAX BLOCK UPON FULL PAYMENT OF PROPERTY TAXES.

Since 1993, counties have collected property taxes on motor vehicles that are registered with the Division of Motor Vehicles on a revolving year-round basis. If the taxes are not paid within four months after the date they are due, the tax collector must send a list of the delinquent taxpayers and their vehicle identification number to the Division. The Division must refuse to renew the vehicle's registration until the taxpayer presents it with a paid tax receipt. This act will allow a county to remove the "block" when the delinquent taxes are paid, rather than require the taxpayer to present a paid tax receipt to the Division at the time the vehicle registration is renewed. To remove the "block", the county tax collector must certify to the Division that the delinquent taxes have been paid. The certification must be in the form and contain the information required by the Division.

This change was requested by the Division of Motor Vehicles. There are about four and one-half months between the time the "block" is electronically put on the vehicle's registration and the time the vehicle registration must be renewed. Taxpayers who pay the property tax within this window of time do not always remember to bring a paid tax receipt with them when they go to renew their vehicle registration. This situation upsets taxpayers who have paid their property taxes but cannot renew their vehicle registration until they find, or obtain a copy of, their paid tax receipt. This act will ease the burden on these taxpayers by allowing the county to remove the "block" at the time the tax is paid. The Division will decide what form the certification must take. The act does not require the counties to submit this certification to the Division because not all of the counties have the capacity to electronically communicate with the Division.

A recommendation of the Joint Transportation Oversight Study Committee.

Chapter 747 (House Bill 1096, Rep. Cansler)

AN ACT TO TRANSFER RESPONSIBILITY FOR COLLECTING THE REMAINDER OF THE GROSS PREMIUMS TAX FROM THE DEPARTMENT OF INSURANCE TO THE DEPARTMENT OF REVENUE AND TO CLARIFY RELATED STATUTES.

This act completes a transfer of responsibility from the Insurance Department to the Department of Revenue that was begun in 1995. The transfer that is completed is the responsibility of collecting the various insurance gross premiums taxes. The act becomes effective January 1, 1997. The act also makes technical and clarifying changes to the affected

statutes.

The insurance gross premiums taxes are taxes based on the amount of insurance premiums that are paid or, for certain self-insurers, would have been paid during the year. They consist of a 1.9% premiums tax on for-profit insurance companies, a 0.5% tax on nonprofit companies, such as Blue Cross/ Blue Shield and Delta Dental, that provide hospital, medical, and dental coverage, a 2.5% tax on workers' compensation premiums and workers' compensation self-insurers, a 1.33% additional fire and lightning tax on property premiums for coverage of property other than motor vehicles and boats, and another 0.5% fire and lightning tax on all property premiums on business inside a municipality.

The 1995 General Assembly, in Chapter 360 of the 1995 Session Laws, transferred the responsibility of collecting the following gross premiums taxes from the Department of Insurance to the Department of Revenue: the general, for-profit 1.9% tax, the 2.5% tax on workers' compensation premiums but not on workers' compensation self-insurers, and the non-profit 0.5% tax. It did not transfer collection of the 2.5% tax on workers' compensation self-insurers or either of the additional fire and lightning taxes. This act transfers collection of those three taxes effective January 1, 1997. The Department of Revenue is already collecting the additional 1.33% fire and lightning tax pursuant to an agreement with the Department of Insurance.

A workers' compensation self-insurer is an employer that carries its own workers' compensation risk or pools its risk with other employers that belong to the same trade or professional association as the employer. The 2.25% gross premiums tax applies to the amount of premiums the employer would be charged if the employer acquired workers' compensation insurance from an insurance company. Two Department of Insurance employees currently administer collection of this tax based on payroll information supplied by employers. The act transfers one position from the Department of Insurance to the Department of Revenue.

Twenty-five percent of the additional 1.33% fire and lightning tax and all of the additional 0.5% fire and lightning tax are used for special purposes. The rest of the gross premiums taxes are credited to the General Fund. Twenty-five percent of the 1.33% fire and lightning tax is credited to the Volunteer Fire Department Fund in the Department of Insurance. The 0.5% fire and lightning tax is credited to the Department of Insurance and is disbursed to local fire fighters' relief funds.

This act does not affect the collection of three special taxes on insurance companies. The three taxes are: a tax on surplus lines insurance, a tax on risk retention by a company chartered in another state, and a tax on unlicensed insurers.

Surplus lines insurance is a market of last resort for commercial property and liability risks. The tax is collected not from insurance companies but from the brokers who place the coverage. The tax is based on information sent in by these brokers, who are called surplus lines licensees, and must be reconciled based on the surplus lines market and other technical factors. The tax is levied on a quarterly basis and is not similar in administration, calculation, or collection to the gross premiums tax.

For risk retention groups chartered in other states, there is a quarterly tax similar to the surplus lines tax. There are only about 35 risk retention groups chartered in other states; their total tax represents less than $250,000 a year. Existing law requires any State-chartered risk retention group to be licensed as an insurance company; it would, therefore, be covered by the

general gross premiums tax collected by the Department of Revenue. In addition, insurers of purchasing groups already pay the gross premiums tax to the Department of Revenue like any other insurance company. If a purchasing group purchases coverage from a surplus lines insurer, however, the surplus lines tax applies to the premiums.

Unlicensed insurers are a special category of insurers, allowed to provide coverage only if the insured makes an affidavit that the insured could not obtain insurance from licensed insurers after diligent search. A detailed report and this affidavit must be filed by the person who procures the insurance within 30 days after the insurance is procured and the tax is due at that time. This tax is closely tied to regulation of the insurers and its collection is not similar to the gross premiums tax.

1996 First Extra Session

Chapter 1, 1996 First Extra Session (Senate Bill 2, Sen. Kerr)

AN ACT TO IMPLEMENT A ZERO UNEMPLOYMENT INSURANCE TAX RATE FOR 1996 FOR ALL EMPLOYERS WITH A POSITIVE EXPERIENCE RATING, ALLOW EMPLOYERS WITH A NEGATIVE RATING TO QUALIFY FOR THE ZERO RATE BY PREPAYING TAXES, REDUCE THE RATE FOR NEW EMPLOYERS FROM ONE AND EIGHT-TENTHS PERCENT TO ONE AND TWO-TENTHS PERCENT, ALLOW NEW EMPLOYERS TO QUALIFY SOONER FOR REDUCED RATES, AND AUTHORIZE A LEGISLATIVE RESEARCH COMMISSION STUDY.

This act continues the General Assembly's past efforts to reduce the amount of money in the Unemployment Insurance Fund and to avoid taxing for a surplus. The act reduces unemployment taxes in three ways and benefits almost every employer:

(1) POSITIVE RATED EMPLOYERS. -- Assigns a one-year zero unemployment insurance tax rate for all positive rated employers. Approximately 115,000 employers have positive rated accounts. The tax reduction enacted in 1995 allowed approximately 15% of these employers to earn a zero tax rate. This act gives the remaining 85% of positive rated employers a zero tax rate for 1996, saving them $135 million. In the absence of any change in circumstances, an employer will resume paying unemployment taxes in 1997 at the same rate the employer would have paid taxes in 1996 if the act had not enacted.

(2) NEGATIVE RATED EMPLOYERS. -- Gives overdrawn employers additional time to make contributions to their accounts so that they may qualify for the zero tax rate in 1996. An employer may make voluntary contributions in order to have a lower tax rate the following year. Generally, voluntary contributions must be made before July 31. It is estimated that 1/2 of the 7,000 employers with a negative rating may contribute $18 million and receive $41 million in tax relief, for a net savings of $23.5 million.

(3) NEW EMPLOYERS. -- Permanently reduces the tax rate for new employers from 1.8% to 1.2%. Nationally, the most common tax rate for new employers is 2.7%. This act also reduces the period of time required for new employers to achieve lower rates from 3 years to 2 years. This would save an estimated 24,000 employers who are not rated $5 million for 1996. The rate was last reduced in 1994 from 2.25% to 1.8%.

The Employment Security Commission estimates that the unemployment tax reduction in this act will save employers between $140 million and $163.5 million for 1996. The act became effective January 1, 1996.

The act authorizes the Legislative Research Commission to study issues relating to the State's Employment Security Law. The Commission did not report to the 1996 Session of the General Assembly. The act directs the Commission to report to the 1997 General Assembly. The act also made a change in the State law so that it conforms with the federal law. Under State law, an employer could not move to a lower rate unless it had a chargeable account for more than 13 consecutive months immediately preceding the date for calculating the employer's tax rate. The act changed the requirement of "13 consecutive months" to "at least 12 calendar months". The latter requirement focuses attention on cumulative employment rather than consecutive quarters. The change removed a technical barrier that would have kept a handful of employers from moving from the standard rate to a reduced rate.

The General Assembly cut the unemployment tax rate in 1993, 1994, and 1995. Despite these cuts, the North Carolina Trust Fund in Washington, from which unemployment benefits are paid, was slightly more than $1.5 billion. It is estimated that this act would reduce the State Unemployment Insurance Trust Fund balance from about $1.5 billion to $1.29 billion in 1996. Without the act, the Trust Fund balance was expected to be reduced to only $1.43 billion in 1996. The 1996 balance in the fund is far more than needed to meet the State's unemployment compensation obligations. North Carolina has the fifth highest Trust Fund balance of any state in the nation relative to the amount of benefits paid out of the Trust Fund in prior years.

In 1995, the General Assembly reduced unemployment insurance taxes by an average of 23% for rated employers with a positive credit balance, set a zero tax rate for employers with credit ratios of 5.0 or over, and reduced from 60% to 50% the percentage of annual average wages used to calculate the taxable wage base. In 1994, the General Assembly reduced unemployment insurance taxes by an average of 38% for rated employers with a positive credit balance and by 20% for employers who are not yet rated. In 1993, the General Assembly enacted legislation that reduced the unemployment insurance tax rate by 30% for rated employers with a credit balance in their unemployment insurance tax account for any calendar year in which the balance in the Unemployment Insurance Trust Fund equals or exceeds $800,000,000 as of the preceding August 1. The 1994 tax cut legislation increased this percentage reduction to 50%. In 1992, the General Assembly suspended an additional unemployment tax collected from employers and credited to the Employment Security Commission Reserve Fund, which bolsters the State Unemployment Insurance Trust Fund.

In 1994, the General Assembly also increased benefits payable to claimants by restoring the pre-1983 formulas for computing unemployment benefits. The North Carolina average weekly benefit amount paid to claimants for unemployment benefits is the highest in the southeast at $188.00. North Carolina also pays the highest maximum weekly benefit amount in the southeast at $297.00. Compared to the 11 largest states in the United States, North Carolina's average benefit ranks 7th and its maximum benefit ranks 4th.

Unemployment tax contributions are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the

treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the Trust Fund.

APPENDIX D

DISPOSITION OF COMMITTEE RECOMMENDATIONS TO THE 1996 SESSION

REVENUE LAWS BILLS - 1996

BILL NO.	SPONSOR	SHORT TITLE	RL NO.	$MILLIONS State Revenues FY 96-97	ENACTED?
S6 (ES)	Kerr	Tax Reform Act of 1996	1	$18.27	In Part
S1179	Kerr	Bosnia Troops Tax Extension	2		Yes
H1094	Cansler	Revise Failure to Pay Penalty	3	Insignificant-	Yes
H1147	Shubert	IRC Reference Update	4	Insignificant	Yes
H1127	Capps	Increase Pay of Property Tax Commission	5	($0.121)	No
H1120	Shaw	Manufactured Homes Property Tax	6		No
H1242	Shubert	Free Food Use Tax	7	Insignificant+	Yes
H1096	Cansler	DOR Collect Premiums Tax	8	($0.134)	Yes
S1198	Kerr	Tax-At-The-Rack & Technical Changes	9	No Effect	Yes
H1119	Shaw	Limit Franchise Add-Back for Debt	10	Insignificant -	Yes
H1099	Neely	Corporate Income Tax Carryforwards	11	($5.0 to $10.0)	No
H1092	Neely	Expand Interstate Audit Division	12	$6.20	In Part
S1178	Cochrane	Technical Bill	13	No Effect	Yes
S1180	Kerr	Reporting 911 Charges on AFIR	14	No Effect	No

APPENDIX E

1996 FEDERAL TAX LAW CHANGES THAT AFFECT STATE TAXABLE INCOME

1996 FEDERAL TAX LAW CHANGES
THAT IMPACT STATE TAXABLE INCOME

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
Damages Exclusion Limited	The amount of damages received on account of personal injuries or sickness was excluded from gross income. The courts have interpreted this provision broadly to include personal injuries that do not relate to a physical injury. The courts have reached differing results in determining how the exclusion applies to punitive damages received in connection with a case involving physical injury or physical sickness.	Generally, punitive damages are not excludable from gross income. Damages received on account of a nonphysical injury or sickness are not excludable from gross income except to the extent the nonphysical injury or sickness is attributable to a physical injury or sickness.	Effective with respect to amounts received after August 20, 1996, unless the amounts were received under a written binding agreement, court decree, or mediation award in effect on September 13 1995.	Additional restrictions placed on the exclusion from income of punitive damages and compensatory damages awarded on account of a nonphysical personal injury or sickness will increase taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
Employer-provided Educational Assistance	Under prior law, an employee's gross income did not include amounts paid or incurred by the employer for educational assistance provided to the employee under a qualified employee educational assistance program. The exclusion of up to $5,250 per calendar year expired for taxable years beginning after December 31, 1994.	The exclusion is retroactively extended. It is now set to expire for tax years beginning after May 31, 1997. The exclusion will not apply to expenses related to graduate level courses beginning after June 30, 1996. The IRS is required to establish expedited procedures for the refund of any taxes overpaid because excludable amounts were included in income after this exclusion lapsed on December 31, 1994. Employers who have previously filed Forms W-2 reporting	The exclusion is restored, effective with respect to tax years beginning after December 31, 1994, and before June 1, 1997. The provision denying the exclusion for graduate-level studies applies to expenses related to courses beginning after June 30, 1996.	The restoration of the exclusion will decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		excludable educational assistance as taxable wages must file corrected Forms W-2c.		
Exclusion for Adoption Expenses	There is no current law.	An employee's gross income will not include amounts paid or expenses incurred by an employer for the employee's qualified adoption expenses pursuant to an adoption assistance program. The total amount excludable, for all tax years, with respect to the adoption of a single child cannot exceed $5,000. The limitation is increased to $6,000 in the case of a child with special needs. The exclusion amount is phased out for taxpayers with	Effective for tax years beginning after December 31, 1996.	Exclusion decreases taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		adjusted gross incomes between $75,000 and $115,000. An adoption assistance program is a separate written plan of an employer for the exclusive benefit of its employees, which provides adoption assistance.		
Spousal IRA	If one spouse has no income, a married couple was allowed a maximum annual deductible IRA contribution of $2,250.	Allows a spouse who has no income to contribute up to $2,000 per year to a deductible IRA, rather than $250.	Effective for tax years beginning after December 31, 1996.	An increase in the amount of a spousal IRA will decrease taxable income.
Early IRA Withdrawals for Medical Expenses and Health Insurance Premiums	Early withdrawals from IRA for medical expenses result in a 10% additional tax on the withdrawal.	The 10% tax will not apply to distributions from an IRA that are used to pay medical expenses in excess of 7.5 % of AGI or that are used to pay health insurance premiums to an individual after	Effective for distributions after December 31, 1996.	No impact on taxable income. Eliminates a tax penalty.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		separation from employment.		
Taxation of Expatriates		The provisions imposing an expatriation tax are expanded to include individuals who are long-term residents of the United States, not just citizens; to presume a tax-avoidance motive for the termination of citizenship or residency if the person meets either a net income test or a net worth test; and to treat additional items of gain and income as US-source income for purposes of the expatriation tax.	These amendments apply to individuals who lose US citizenship and to long-term residents who terminate US residency on or after February 6, 1995.	These amendments will increase taxable income.
Home Office Deduction	A taxpayer can deduct from gross income expenses related to a storage unit in the	The deduction has been expanded to include product samples so that a	Effective for tax years beginning after December 31, 1996.	The expanded deduction will decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
	taxpayer's home that is regularly used for inventory of the taxpayer's business of selling products where the home is the sole fixed location of the business.	taxpayer need not attempt to distinguish between inventory and product samples.		
Increase in Small Business Expensing	Eligible taxpayers may elect to deduct, rather than depreciate, up to $17,500 of the cost of qualified business property in the year that the property is placed into service.	The expense limitation is increased from $17,500 to $25,000 over a seven year period.	Effective for tax years beginning after December 1, 1996.	The increase in the expense limitation of depreciable property will decrease taxable income.
Medical Savings Accounts	No prior law.	PILOT PROGRAM. MSAs will be available to qualified individuals on a first-come, first-serve basis until a national limit of 750,000 is reached. MSAs are a new type of savings vehicle similar to an IRA.	Effective on a pilot basis in tax years beginning after December 31, 1996.	MSAs will reduce taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		Within limits, contributions to a MSA will be deductible from gross income if made by an eligible individual and will be excluded from gross income if made by an employer on behalf of an eligible individual. Distributions from an MSA that are used to pay health care expenses are excludable from income. Distributions for other purposes are taxed. An additional 15% penalty tax applies unless the distribution is made after age 65 or upon death or disability. To be eligible to participate in the pilot group, an individual		

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		must be either self-employed or employed by a small employer having 50 or fewer employees. The individual must also elect coverage under a high deductible plan. The maximum contribution to an MSA for a year is 65% of the deductible under the high-deductible plan for individual coverage and 75% of the deductible in the case of family coverage.		
Long-term Care Insurance	No prior law.	Amounts received by a chronically ill individual under a long-term care insurance contract are excluded from gross income. The exclusion is capped at $175 per day for per diem	Effective for tax years beginning after December 31, 1996.	The exclusion will decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		contracts.		
Medical Expense Deduction for Long-term Care Services and Premiums	A taxpayer may deduct medical expenses that exceed 7.5% of the taxpayer's adjusted gross income.	Unreimbursed amounts paid for qualified long-term care services are treated as medical care for purposes of the medical expense deduction. Eligible long-term care insurance premiums that do not exceed certain limits are treated as medical expenses for purposes of the medical expense deduction.	Effective for tax years beginning after December 31, 1996.	The increased deduction will decrease taxable income.
Accelerated Death Benefit Exclusion	Some confusion under prior law.	Clarifies that accelerated death benefits received under a life insurance contract on the life of an insured, terminally or chronically ill individual may be excluded from gross income.	Effective for amounts received after December 31, 1996.	The exclusion will decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
Self-Employed Heath Insurance Deduction	Thirty percent of the heath insurance expenses of self-employed individuals and their spouses and dependents are deductible from the individual's gross income. The health insurance deduction is available to general partners in a partnership and to shareholders owning more than 2% of the outstanding stock of an S-corporation.	The 30% limit is increased to 80%, phased in over a 10 year period.	Effective for tax years beginning after December 31, 1996.	The increased deduction will decrease taxable income.
Self-Insured Plans	Payments for personal injury or sickness through health or accident insurance is excludable from gross income.	Payments for personal injury or sickness through arrangements having the effect of health or accident insurance is excludable from gross income. This provision equalizes the tax treatment of	Effective for tax years beginning after December 31, 1996.	The exclusion will decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		payments from self-insured plans with payments receive from commercial insurance.		
S Corporation Simplification		The maximum number of shareholders of an S corporation is increased from 35 to 75. Certain trusts may hold S corporation stock. The provision permits broader estate planning opportunities for S corporation shareholder by allowing trusts to be funded with S corporation stock. Certain exempt organizations allowed to be shareholders.	Effective for tax years beginning after December 31, 1996. Effective for tax years beginning after December 31, 1996. Effective for tax years beginning after December 31, 1997.	Negligible

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		Allows domestic building and loan associations, any mutual savings bank and any cooperative bank without capital stock organized and operated for mutual purposes and without profit to qualify as an S corporation. S corporations allowed to own 80% or more of the stock of a C corporation and to own a qualified subchapter S subsidiary (QSSS).	Effective for tax years beginning after December 31, 1996. Effective for tax years beginning after December 31, 1996.	
SIMPLE Retirement Plans	No prior law.	Employers with 100 or fewer employees who received at least $5,000 in compensation from the employer in the preceding year may	Effective for tax years beginning after December 31, 1996.	Excluded contributions decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		adopt a new simplified retirement plan - the Savings Incentive Match Plan for Employees. The plan allows employees to make elective contributions of up to $6,000 per year and requires employers to make matching contributions.		
Lump Sum Distributions	Allowed recipients of a lump sum distribution from a pension plan to pay the tax liability over a five year period by averaging the liability.	The five year averaging for lump sum distributions is repealed. This provision means the recipient of a lump sum distribution must either pay tax on the entire amount at ordinary income tax rates or defer tax on the distribution by rolling part of all of it into an IRA or another	Effective for tax years beginning after December 31, 1999.	Increases taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		qualified plan.		
Death Benefit Exclusion	The beneficiary or estate of a deceased employee could exclude up to $5,000 in benefits paid by or on behalf of an employer by reason of the employee's death.	The exclusion is repealed.	Applies with respect to decedents dying after August 20, 1996.	The repeal of the exclusion will increase taxable income.
Annuity Contracts		This provision simplifies the method for determining the portion of an annuity distribution that represents nontaxable return of basis. Under this new provision, the portion of each annuity payment that represents nontaxable return of basis is generally equal to the employee's total investment in the contract as of the annuity starting date, divided by the	Effective for annuities commencing after November 17, 1996.	Decrease taxable income.

PROVISIONS	PREVIOUS FEDERAL LAW	1996 FEDERAL TAX LAW CHANGES	EFFECTIVE DATE	IMPACT ON STATE REVENUES
		number of anticipated payments. The number of anticipated payments is determined by a chart that is based on the age of the participant.		
Required Distributions	Participants in qualified plans must begin receiving distributions after attaining age 70 ½.	Persons age 70 ½ who are still employed will not have to begin receiving distributions from their qualified plans. Distributions must begin by April 1 of the calendar year following the later of (1) the calendar year in which the employee reaches age 70 ½ or (2) the calendar year in which the employee retires. The modified required beginning date for distributions does not apply to 5% owners or to IRA holders.	Effective January 1, 1997.	Decrease taxable income.

APPENDIX F

INFORMATION ON COUNTY AND CITY PRIVILEGE LICENSE TAXES

November 25, 1996

MEMORANDUM

TO: Revenue Laws Subcommittee on Privilege License Taxes

FROM: Richard Bostic

SUBJECT: Part 1 - County Privilege License Taxes

When the Revenue Laws Subcommittee on Privilege License Taxes last met in the Spring of 1996, it recommended an interim study of the repeal of local privilege license tax restrictions and authorizations in Article 2 of Chapter 105 of the General Statutes. Based on this directive, the Fiscal Research Staff surveyed cities and counties to ascertain how they are using their authority to levy privilege license taxes. This first of two reports will discuss the results of the county survey returned by all 100 counties.

TAX AUTHORITY

G.S. 153A-152 states that "A county may levy privilege license taxes on trades, occupations, professions, businesses, and franchises to the extent authorized by Schedule B of the Revenue Act." The only county license taxes authorized by law are as follows:

Alcoholic beverage businesses (105-113.78) NOT INCLUDED IN REPORT
Animal shows - circuses, menageries, wild west shows, dog and/or pony shows (105-38)
Bagatelle tables and comparable amusements (105-102.5)
Billiard parlors and pool halls (105-102.5)
Bowling Alleys (105-102.5)
Electronic video games (105-66.1)
Games of Skill - shooting galleries and comparable amusements (105-102.5)
Juke boxes (105-65)
Places for "game or play with or without name" not otherwise taxed (105-102.5)
Riding devices - merry-go-rounds, hobby horses, switchback railways and similar amusements (105-102.5)
Swimming pools, skating rinks, and similar amusements (105-102.5)
Automatic sprinkler systems sale or installation (105-55)
Elevator sale or installation (105-55)
Automotive equipment and supply dealers, wholesale (105-89)
Firearms dealers (105-80)
Weapons Dealers (105-80)

Motorcycle dealers (105-89.1)
Motor vehicle dealers (105-89)
Automotive service stations (105-89)
Employment agents (105-90)
Specialty market/flea market operators (105-53)
Fortune Tellers (105-58)
Itinerant merchants (105-53)
Loan agencies (105-88)
Pawnbrokers (105-50)
Peddlers (105-53)

If a county wishes to levy one of the above privilege license taxes it must adopt an ordinance setting the tax amount and the time period to be taxed. The tax is for a twelve month period that usually begins July 1 and ends June 30. The ordinance does not have to be revised each year.

COUNTY TAXES

In the survey, forty six counties reported having no privilege license taxes. Four counties reported having at least one privilege license tax but no revenue. The remaining fifty counties have privilege license taxes and receive revenue from these taxes. The attached map shows the privilege tax revenue earned by each county. The 50 counties reporting revenue earned a total of $569,586 in FY 1995-96. (see attached chart) In comparison to the property tax revenues in the same fiscal year, the privilege tax is equivalent to less than a fraction of one penny on the property tax.

Shown below is the number of counties choosing each tax authorized by statute:

Automobile dealers	45	Flea market operators	13
Auto parts suppliers	44	Fortune tellers	13
Service stations	44	Bowling alleys	12
Pawnbrokers	43	Circuses/Fairs	12
Electronic Video Games	42	Elevators	9
Firearms dealers	42	Weapons dealers	8
Peddlers	41	Specialty markets	8
Loan agencies & brokers	40	Automatic sprinklers	7
Pool Tables	40		
Music machines	39		
Motorcycle dealers	32		
Amusements	23		
Itinerant merchants	21		
Employment agents	20		
Peddlers on foot	15		

NO TAX AUTHORITY

Dr. William A. Campbell in his book North Carolina City and County Privilege License Taxes recommends that each local government review its ordinance " to ensure that it is current with the limitations of Schedule B and other relevant statutes". Dr. Campbell goes on to state that local governments "sometimes continue to levy taxes under invalid ordinance provisions, requiring refunds to taxpayers and causing embarrassment to tax officials". Such is the case with some of North Carolina's counties.

I. **Metallic Cartridges** - Seven counties charge stores $5 for selling metallic cartridges for firearms. Prior to 1987, GS 105-80(b) authorized cities and counties to levy a privilege license tax of up to $5 on persons who sold metallic cartridges but not other weapons. A rewrite of this statute in 1987 eliminated the requirement for this license and thus local governments authority to levy it.

II. **Laundries** - Ten counties are charging a $12.50 rate on laundries that was abolished from the statutes in revisions made in 1991 (1991 S.L. chapter 479) and in 1992 (1991 S.L. chapter 955, s.18).

III. **Service Stations** - Eleven counties are using a per pump rate that was revised in 1989 (1989 S.L. chapter 584, s. 27) to a flat rate of $12.50.

IV. **General Contractors** - One county charges contractors $25 though prohibited from doing so by GS 105-54(g).

V. **Restaurants** - One county charges restaurants $20 though prohibited from doing so by GS 105-62(c).

VI. **Sundries** - One county charges stores $4 for sundries though prohibited from doing so by GS 105-102.5 (e).

VII. **T.V. Sales Service** - One county charges $5 though prohibited from doing so by GS 105-102.5(e).

VIII. **Massage Parlor/Massage Therapist** - Two counties tax massage parlors and one of the two tax massage therapists. Staff Counsel Sabra Faires could find no general taxing authority for this type of business.

IX. **Mobile Home Dealers/Mobile Home Supply** - Eight counties tax mobile home dealers and one county taxes mobile home supplies. These counties must consider mobile homes to be motor vehicles and tax under the authority of GS 105-89(c).

X. **Misc. Business** - Three counties tax Miscellaneous Business. If these businesses are not included in GS 105-102.5(b) (5)(6)(8), then the taxes are not authorized.

XI. **Others** - Counties reported taxes on fireworks, crafts, general retail, junk/scrap metals, hardware, and small motor repair. There is no tax authority for levies on these businesses.

EXCEEDING AUTHORITY

For the following businesses, the counties levying a tax are using the maximum tax rate allowed by the state:

Employment Agencies	20 counties use the $100 rate
Firearms Dealers	42 counties use the $50 rate
Automatic Sprinklers	7 counties use the $100 rate
Elevators	9 counties use the $100 rate
Loan agencies	40 counties use the $100 rate
Weapons Dealers	8 counties use the $200 rate

However for some businesses, counties are exceeding the state rate.

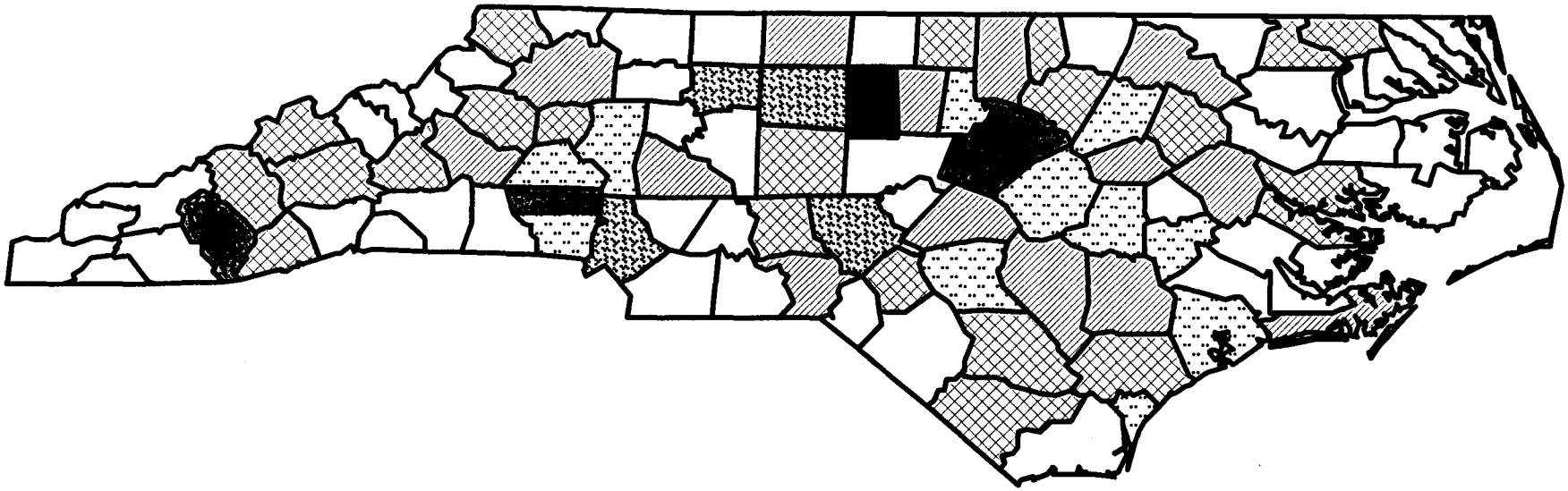
Automobile Dealers	5 counties
Auto Parts Suppliers	2 counties
Circuses	4 counties
Electronic Video Games	2 counties
Motorcycle Dealers	5 counties
Music Machines	1 county
Pawnbrokers	2 counties

REGULATORY

One county finance officer uses the privilege license to regulate business in the county. When applying for the tax, the county can check to see if the business is meeting zoning and other local laws before issuing the license. The county official said the regulatory power of the tax was more important than the revenue the tax generated.

Other counties may use the tax to regulate undesirable businesses. For example, thirteen counties have taxes on fortune tellers ranging from $200 to $1000, with the median rate being $200. The state does not limit what a county can charge fortune tellers. Another example is pawnbrokers. Most counties charge near the $275 rate for pawnbrokers and one county exceeds the maximum with a $1000 rate.

COUNTY PRIVILEGE LICENSE TAXES
1995-96



No Privilege License Taxes
Taxes - Generated No Revenue
$30 to $4,705.01
$4,705.02 to $9,822.50
$9,922.51 to 28,387
$28,388 to $112,231

Source: Fiscal Research Division Survey

COUNTY PRIVILEGE LICENSE TAX

County	1995 Population (1)	Privilege License Revenue (2)	Property Tax Revenues (3)
Alamance	115,295	$ -	$26,073,438
Alexander	30,168	$ 2,166	$5,661,182
Alleghany	9,618	$ -	$3,330,700
Anson	23,828	$ -	$6,412,190
Ashe	22,992	$ 90	$5,428,800
Avery	15,186	$ -	$6,572,000
Beaufort	43,330	$ 4,156	$12,120,000
Bertie	20,638	$ -	$4,367,958
Bladen	29,790	$ 3,278	$8,650,000
Brunswick	60,739	$ -	$37,615,065
Buncombe	188,736	$ 730	$63,640,831
Burke	81,440	$ 6,121	$17,180,000
Cabarrus	110,338	$ -	$30,052,632
Caldwell	73,726	$ 2,590	$14,464,450
Camden	6,316	$ -	$1,888,113
Carteret	57,612	$ 5,552	$15,174,445
Caswell	21,372	$ -	$4,692,679
Catawba	126,240	$ 11,464	$34,149,839
Chatham	42,914	$ -	$14,075,872
Cherokee	21,824	$ -	$3,143,171
Chowan	14,031	$ -	$4,157,698
Clay	7,732	$ -	$1,919,012
Cleveland	89,136	$ -	$21,078,760
Columbus	51,268	$ 3,625	$14,241,566
Craven	85,816	$ -	$19,417,086
Cumberland	294,010	$ 28,387	$69,519,475
Currituck	15,818	$ -	$8,305,155
Dare	25,758	$ -	$16,239,200
Davidson	136,604	$ -	$24,880,500
Davie	29,735	$ -	$8,060,340
Duplin	42,772	$ 5,746	$11,122,689
Durham	192,906	$ 12,025	$93,321,608
Edgecombe	56,811	$ 2,500	$15,204,942
Forsyth	279,904	$ 68,295	$114,001,797
Franklin	41,649	$ 300	$11,232,000
Gaston	178,442	$ 14,814	$53,020,800
Gates	9,798	$ 30	$2,757,099
Graham	7,466	$ -	$1,750,018
Granville	41,130	$ 4,705	$9,620,139
Greene	16,794	$ -	$3,432,093
Guilford	372,097	$ 51,743	$153,881,995
Halifax	57,468	$ 6,182	$12,946,800

COUNTY PRIVILEGE LICENSE TAX

County	1995 Population (1)		Privilege License Revenue (2)	Property Tax Revenues (3)
Harnett	76,960	$	7,806	$14,732,808
Haywood	49,946	$	2,800	$15,055,074
Henderson	76,250	$	-	$22,017,849
Hertford	22,468	$	3,835	$5,993,608
Hoke	27,334	$	1,698	$5,517,344
Hyde	5,211	$	-	$2,857,790
Iredell	103,462	$	11,553	$24,970,725
Jackson	28,798	$	-	$8,793,463
Johnston	95,413	$	19,880	$23,234,119
Jones	9,502	$	-	$2,390,740
Lee	46,014	$	-	$14,427,000
Lenoir	59,083	$	13,130	$16,600,000
Lincoln	55,592	$	-	$15,128,114
Macon	37,244	$	2,141	$8,943,806
Madison	26,284	$	-	$3,580,768
Martin	17,778	$	655	$8,479,873
McDowell	25,842	$	-	$8,123,551
Mecklenburg	577,479	$	112,231	$324,769,200
Mitchell	14,838	$	-	$3,044,165
Montgomery	23,828	$	150	$6,532,005
Moore	66,660	$	6,978	$17,850,000
Nash	83,966	$	14,830	$19,306,005
New Hanover	139,577	$	25,416	$53,096,400
Northampton	20,726	$	-	$5,897,087
Onslow	147,912	$	19,452	$19,741,287
Orange	105,821	$	6,058	$45,105,516
Pamlico	11,869	$	-	$3,702,098
Pasquotank	33,290	$	-	$7,045,000
Pender	34,671	$	3,833	$10,802,480
Perquimans	10,650	$	-	$3,177,559
Person	32,139	$	3,920	$12,410,359
Pitt	117,420	$	8,931	$28,084,617
Polk	15,743	$	-	$4,069,345
Randolph	115,548	$	250	$21,264,185
Richmond	45,404	$	5,312	$10,335,728
Robeson	110,990	$	-	$21,304,483
Rockingham	88,334	$	8,566	$21,787,597
Rowan	118,875	$	9,823	$31,116,630
Rutherford	59,082	$	-	$14,041,832
Sampson	50,523	$	6,991	$11,797,092
Scotland	34,718	$	-	$11,019,167
Stanly	53,784	$	-	$13,247,339

COUNTY PRIVILEGE LICENSE TAX

County	1995 Population (1)		Privilege License Revenue (2)	Property Tax Revenues (3)
Stokes	41,071	$	-	$9,000,000
Surry	65,076	$	-	$13,586,443
Swain	11,568	$	-	$1,665,710
Transylvania	27,168	$	1,356	$10,310,595
Tyrrell	3,812	$	-	$1,523,699
Union	98,192	$	-	$28,797,090
Vance	40,041	$	4,055	$9,586,800
Wake	518,271	$	-	$190,875,000
Warren	18,137	$	-	$6,038,834
Washington	13,766	$	-	$3,674,162
Watauga	40,133	$	-	$9,443,486
Wayne	111,018	$	15,902	$17,452,188
Wilkes	62,056	$	8,046	$13,490,400
Wilson	67,839	$	9,494	$19,619,400
Yadkin	33,672	$	-	$7,274,096
Yancey	16,143	$	-	$3,712,027
Total	**7,194,238**	**$**	**569,586**	**$2,252,247,875**

(1) Office of State Planning

(2) Fiscal Research Division county survey for FY 1995-96

(3) NC Assoc. of County Commissioners 1995-96 Budget & Tax Survey

December 2, 1996

MEMORANDUM

TO: Revenue Laws Subcommittee on
Privilege License Taxes

FROM: Richard Bostic

SUBJECT: Part 2 - City Privilege License Taxes (Preliminary - Revised)

In October, a survey was sent to all municipalities that had reported privilege license tax revenues to the State and Local Government Finance Division of the Department of State Treasurer in 1995. The survey requested information on the rates, number of licenses, and revenues on those privilege licenses under Schedule B that restrict the amount a city can charge.(see attached list) The survey also gave cities an opportunity to list the privilege taxes they levy under their general tax authority. It is these "other taxes" that have presented staff with a monumental task in data entry. Much of the data has been entered but has not been proofed for accuracy. The Information Systems Division is helping construct a database management system that will enable Fiscal Staff to better query the data. This database should be ready after Thanksgiving and a report can be prepared for the December meeting.

In the meantime there are a few observations that can be made about municipal privilege license taxes.

⇒ Based on data from the Department of Revenue, 355 of the 527 municipalities levy privilege license taxes.

⇒ In FY 1994-95, municipalities reported to the Department of Revenue earnings of $20.4 million from privilege licenses. The cities of Charlotte, Asheville, Winston-Salem, Greensboro, Raleigh and High Point accounted for 69.8% of that total. (see attached chart)

⇒ GS 160A-211 states that "except as otherwise provided by law, a city shall have the power to levy privilege license taxes on all trades, occupations, professions, businesses, and franchises carried on within the city". With additional businesses yet to be keyed from the survey, there are at least 210 business categories taxed by cities.

⇒ Many of the smaller towns and cities have not kept their ordinances current with revisions in state law. Many finance directors and tax collectors admitted they inherited the tax ordinances from previous administrators and had not questioned the rates.

1) Service stations - Towns are still using the per pump rate that was revised to a flat rate in 1989.
2) Pool tables - Many cities still base this tax on the size and number of pool tables, but this law was repealed in 1989 and replaced with a $25 flat rate.
3) Restaurants - Towns and cities still use the 50 cents per chair rate that was replaced in 1990 with two rates ($25 if 4 or less seats and $42.50 if greater than 4 seats).
4) Metallic cartridges - Thirteen cities still charge a $5 fee for a license that was repealed in 1987.

⇒ Many of the towns have rates that exceed the state cap. For example, 48 cities have rates that exceed the $5 rate for Piano, TV, Radio repairs and sales. Another 27 cities have rates that exceed the $2.50 rate for ice cream sales.

⇒ Several towns have imposed license taxes that appear to be prohibited by law. The following are businesses being taxed by at least one town:

Auction
Bank
Bottled water/drinks
Appliance sales/repairs
Dentist
Healthcare provider
Insurance
Trucking
Realty
Tax/accounting services

⇒ Three towns abolished their privilege license tax in 1995. In phone conversations with town finance directors, town clerks, and tax collectors in several small cities, there was a willingness to abolish the tax. Many felt the revenue earned by the tax barely paid for the cost to administer it. This opinion was not shared by the larger cities.

⇒ Many of the larger cities in the state use a gross receipts tax. The rate restrictions imposed by the state on certain businesses creates an inequity in the amount of tax paid by businesses in these communities.

Appendix B

Table of Statutes

I. City License Taxes—Restricted by Law

Occupation, business, etc.	G.S.
Alcoholic Beverage Businesses	
Malt beverages, wholesale	105-113.79
Malt beverages, retail	105-113.77
Unfortified wine, wholesale	105-113.79
Unfortified wine, retail	105-113.77
Fortified wine, wholesale	105-113.79
Fortified wine, retail	105-113.77
Amusements	
Animal shows, e.g., circuses, menageries, wild west shows, dog and/or pony shows	105-38
Athletic contests	105-37.1
Bagatelle tables and comparable amusements	105-102.5
Billiard parlors and pool halls	105-102.5
Bowling alleys	105-102.5
Electronic video games	105-66.1
Games of skill, e.g., shooting galleries and comparable amusement	105-102.5
Juke boxes (music machines)	105-65
Places for "games or play with or without name," not otherwise taxed	105-102.5
Riding devices, e.g., merry-go-rounds, hobby horses, switchback railways (roller coasters?), and similar amusements	105-102.5
Swimming pools, skating rinks, and similar amusements	105-102.5
Theaters, motion picture	105-37
Theaters, outdoor drive-in	105-36.1
Videos, sale or rental	105-102.5
Other amusements for which admission is charged, not otherwise taxed	105-37.1
Building-Trade Occupations	
Automatic sprinkler systems, sale or installation	105-55
Contractors, construction	105-54
Contractors, electric	105-91
Contractors, heating	105-91
Contractors, plumbing	105-91
Elevators, sale or installation	105-55

Continued on page 52.

I. City License Taxes—Restricted by Law (cont'd)

Occupation, business, etc.	G.S.
Manufacture and/or Sale of Particular Products	
Automotive equipment and supply dealers, wholesale	105-89
Bicycle dealers	105-102.5
Coffins, retail dealers	105-46
Firearms dealers	105-80
Ice cream: manufacturer, wholesaler, distributor, retailer	105-97, 105-102.5
Motorcycle dealers	105-89.1
Motor vehicle dealers	105-89
Oils (illuminating oil and greases, benzine, naphtha, gasoline, etc.), sale	105-72
Phonographs: sale, repair, or maintenance	105-102.5
Phonograph records, sale	105-102.5
Pianos and organs: sale, repair, or maintenance	105-102.5
Radios and accessories: sale, repair, or maintenance	105-102.5
Sundries	105-102.5
Television sets and accessories: sale, repair, or maintenance	105-102.5
Weapons dealers (e.g., bowie knives, dirks, daggers, iron or metallic knuckles)	105-80
Service Occupations and Businesses	
Advertisers, outdoor	105-86
Automotive service stations	105-89
Barber shops	105-75.1
Beauty parlors	105-75.1
Dry cleaners and pressing clubs, including solicitation from out of state	105-74
Hat blockers	105-74
Laundries, including laundromats	105-85
Linen supply companies	105-85
Employment agents, emigrant	105-90
Employment agents, domestic	105-90
Hotels, motels, tourist homes, etc.	105-61
Campgrounds, trailer parks, etc.	105-102.5
Restaurants, cafeterias, other places where prepared food is sold	105-62
Taxicabs and motor vehicles	20-97
Undertakers[1]	105-46
Utilities	
Electric companies	105-116(e)
Express companies	105-118(d)
Gas companies	105-116(e)
Sewer companies	105-116(e)
Telegraph companies	105-119(e)
Water companies	105-116(e)
Other Businesses and Occupations	
Chain stores	105-98
Collection agencies	105-45
Specialty market operators	105-53
Itinerant merchants	105-53
Loan agencies	105-88
Pawnbrokers	105-50
Peddlers	105-53
Security dealers	105-67
Tobacco warehouses	105-77

1. Under N.C. Gen. Stat. § 105-41, cities may not tax morticians and embalmers.

II. City License Taxes—Prohibited by Law

Occupation, business, etc.	G.S.
Alcoholic Beverage Businesses	
Malt beverages, brewery	105-113.70(d)
Unfortified wines, winery	105-113.70(d)
Fortified wines, winery	105-113.70(d)
Amusements	
Motion pictures: manufacture, sale, lease, furnishing, and distribution	105-36
Dealers in Various Types of Merchandise	
Automatic machines	105-102.5
Burglar alarms, dealers	105-51.1
Household appliances (refrigerators, washing machines, and vacuum cleaners), dealers	105-102.5
Office equipment (cash registers, typewriters, adding or bookkeeping machines, billing machines, check protectors, addressograph machines, duplicating machines, card-punching, assorting, and tabulating machines), dealers	105-102.5
Occupations and Professions Subject to Licensing Boards	
Accountants	105-41
Architects	105-41
Attorneys	105-41
Auctioneers	85B-6
Chiropodists	105-41
Chiropractors	105-41
Dentists	105-41
Embalmers	105-41
Engineers, professional	105-41
Healers, professional	105-41
Land surveyors	105-41
Landscape architects	105-41
Morticians	105-41
Ophthalmologists	105-41
Opticians	105-41
Optometrists	105-41
Osteopaths	105-41
Pest control applicators	106-65.40
Photographers	105-41
Physicians	105-41
Private detectives	105-42
Real estate agents	105-41
Real estate appraisers	105-41
Surgeons	105-41
Veterinarians	105-41
Utilities	
Bus companies	105-120.1
Pullman, sleeping car, chair car, dining, car, operators	105-117
Telephone companies	105-120(d)
Trucking companies licensed by the state	20-97(b)
Other Businesses and Occupations	
Banks	105-102.3
Bondsmen	58-71-190
Cooperative-marketing associations	105-102.1
Corporations, domestic and foreign[2]	105-122(g)
Credit bureaus	105-57
Installment paper dealers	105-83
Insurance companies	105-228.10
Motor fuel, wholesale sale or distribution	105-99
Production credit associations	105-102.1
Savings and loan associations	105-228.24
Soft drinks: manufacture, production, bottling, and/or distribution	105-113.50
Vending machines, including weighing machines	105-65.1

2. N.C. Gen. Stat. § 105-122 prohibits taxing the "franchise" of corporations, that is, the right to engage in business in the corporate form. It does not prohibit the levy of license taxes on corporations because of the business or businesses in which the [illegible] corporation does or does not model (N.C. Gen. Stat. § 105-61)