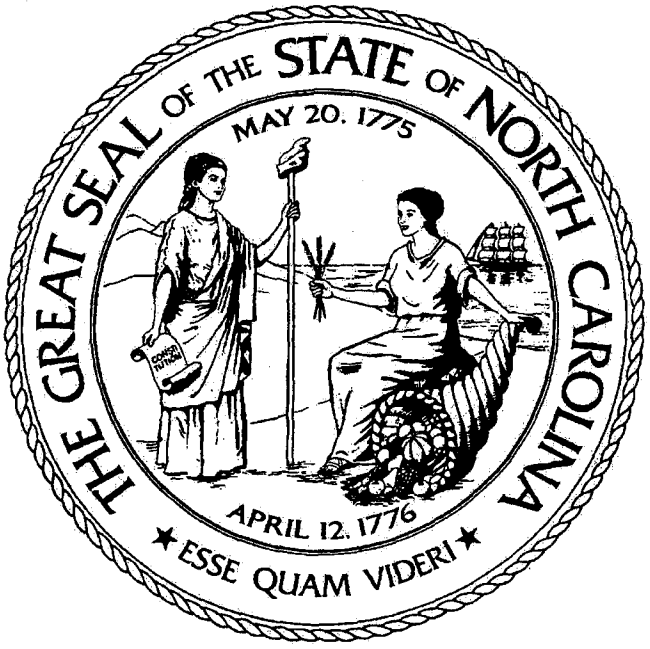
REVENUE LAWS STUDY COMMITTEE



REPORT TO THE 1999 GENERAL ASSEMBLY OF NORTH CAROLINA 2000 REGULAR SESSION

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REVENUE LAWS STUDY COMMITTEE
State Legislative Building
Raleigh, North Carolina 27603

Senator John H. Kerr, III, Co-Chair ***Representative Paul Luebke, Co-Chair***

April 27, 2000

TO THE MEMBERS OF THE 1999 GENERAL ASSEMBLY (REGULAR SESSION 2000):

The Revenue Laws Study Committee submits to you for your consideration its report pursuant to G.S. 120-70.106.

Respectfully Submitted,

Rep. Paul Luebke, Co-Chair

Sen. John Kerr, Co-Chair

1999-2000

REVENUE LAWS STUDY COMMITTEE

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PREFACE

The Revenue Laws Study Committee is established in Article 12L of Chapter 120 of the General Statutes, to serve as a permanent legislative commission to review issues relating to taxation and finance. The Committee consists of sixteen members, eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. Committee members may be legislators or citizens. Each of the appointing authorities designates one member to serve as co-chair. The co-chairs for 1999-2001 are Senator John Kerr and Representative Paul Luebke.

G.S. 120-70.106 gives the Revenue Law Study Committee's study of the revenue laws a very broad scope, stating that the Committee "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." A copy of Article 12L of Chapter 120 of the General Statutes is included in Appendix A. A committee notebook containing the committee minutes and all information presented to the committee is filed in the Legislative Library.

Before it was created as a permanent legislative commission, the Revenue Laws Study Committee was a subcommittee of the Legislative Research Commission. It has studied the revenue laws every year since 1977.

COMMITTEE PROCEEDINGS

The Revenue Laws Study Committee met four times before the convening of the 2000 Regular Session of the 1999 General Assembly. 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 principles 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, levy of low rates on a broad tax base, stability and responsiveness as a source of revenue, administrative efficiency, simplicity, and ease of compliance.

The Revenue Laws Study Committee first reviewed the tax law changes enacted during the 1999 Session and the fate of the Committee's recommendations to that session. Four of its six proposals to the 1999 Session were enacted in whole or in part in 1999. Appendix B contains a summary of all tax legislation enacted in 1999 and Appendix C lists the Committee's recommendations and the action taken on them in 1999.

The Committee made an in-depth study of three major issues:

- ✓ The need to simplify sales and use taxes to enhance collection by out-of-state retailers who make sales through catalogs and the Internet.
- ✓ Whether to provide property tax relief for continuing care retirement centers that, because they are not charitable, do not qualify for the current law exemption for charitable institutions.
- ✓ The need to simplify and revise taxes on telecommunications in light of recent technology changes.

Legislative Proposal 2 is the Committee's recommendation to simplify sales and use taxes to enhance collection by out-of-state retailers who make sales through catalogs and the Internet. The proposal implements the streamlined sales tax collection system recommended by the National Governor's Association. By certifying a software program and a sales tax collector, the legislation would make it possible for North Carolina to participate in the new system, which shifts sales tax administration from remote, out-of-state retailers to a technology-oriented business model administered by a third party certified as the sales tax collector. Under the system, a participating retailer would integrate the certified software program with its system. The certified software program would be able to determine the applicable state and local use tax due on a transaction at the time of the sale. The customer would pay the retailer the full amount of the purchase, including the tax. The Certified Sales Tax Collector would be able to debit the retailer's account on an agreed upon schedule for the amount of tax owed all participating states according to transactions processed by the Collector. The Collector would remit the applicable tax to each state. Legislative Proposal 2 also contains other tax law changes to better enable the Department of Revenue to collect taxes owed to the State.

The Committee asked a subcommittee consisting of both members and interested parties to study property tax relief for continuing care retirement centers and to recommend a fair means for taxing continuing care retirement centers that are not charitable. Charitable retirement centers are exempt from property tax, but the General Assembly has struggled with the question of taxing non-profit centers that do not meet the definition of charitable. The most recent law governing these non-charitable centers sunsets July 1, 2000. The subcommittee met six times but was unable to reach an agreement that was acceptable to both taxpayers and local governments. As a result, Legislative Proposal 4 recommends that the sunset of the current law be extended for

one year to give the parties more time to work out a compromise. Appendix D contains a summary of the meetings held by the subcommittee.

Legislative Proposal 9 represents the Committee's recommendation regarding telecommunications. The current taxes on telecommunications are complex and do not address forms of telecommunications that were not in existence the last time the taxes were modified, in the 1980s. Legislative Proposal 9 simplifies the law and begins addressing some of the problems created by evolving telecommunications technology. The proposal combines the two separate telecommunications taxes into one tax, making the method for sharing telecommunications tax revenue with municipalities simpler and fairer. It broadening the tax base to include interstate telecommunications while lowering the rate to 4.5%. It also provides a simpler way to tax pre-paid telephone cards and similar devices. The Committee recognized that the telecommunications industry is changing rapidly and that its proposal does not address all the concerns in this area. However, the proposal is a step towards modernizing the State's taxation of telecommunications.

The Committee recognized that a sound tax structure is one that is simple and easy for taxpayers to comply with and is inexpensive for the Department of Revenue to administer. The first step to simplicity is to conform the tax structure as much as possible to federal tax laws that taxpayers must already comply with. Accordingly, the Committee adopted Legislative Proposal 1, its annual recommendation that references in State tax statutes to the Internal Revenue Code be updated to include recent federal amendments made during the past year. Updating the references provides that to the extent State law already piggybacks federal law, it will be consistent with recent federal law changes. Legislative Proposal 1 also returns State law concerning the deadline for payment of estimated taxes by farmers and fishers to conformity with federal law. The Committee's Legislative Proposal 6 brings the State's tax structure into further conformity with federal law, by requiring State tax withholding on certain pension

payments, known as eligible rollover distributions, to the same extent as federal withholding is required.

As in the past, the Committee proved to be an excellent forum for taxpayers, local government officials, and State 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 needed to be resolved. As a result of input from taxpayers, and in order to enhance the fairness of the State's tax system, the Committee recommends two proposals: Legislative Proposal 3, which provides a mechanism for taxpayers to receive a refund of the deed transfer tax if it is paid in error, and Legislative Proposal 5, which removes from the Bill Lee Act two provisions that inadvertently deny taxpayers credits when they otherwise satisfy the law's conditions for receiving incentives.

The Revenue Laws Study Committee recommends several legislative proposals that seek to enhance the efficiency and fairness of tax administration. Legislative Proposal 4 provides that the property tax exemption for health care facilities financed with Medical Care Commission bonds extends only to the part of the facility financed with the bonds. Legislative Proposal 5 clarifies that if a taxpayer receives a tax credit because it is engaging in an eligible business, the taxpayer loses future installments of the credit if it ceases to engage in an eligible business. Legislative Proposal 1 clarifies that interstate corporations that apportion income to North Carolina cannot inflate their apportionment formula by treating working capital as gross receipts. Legislative Proposal 7 provides that individuals appointed to the Property Tax Commission to decide appeals of property tax disputes may be reimbursed for time spent being trained in property tax and judicial matters. And Legislative Proposal 10 clarifies that standing timber is considered real property for purposes of the deed transfer tax.

The Revenue Laws Study Committee strongly supports a policy of administering taxes so that taxpayers cannot easily avoid paying the taxes they owe. When some taxpayers do not pay their taxes, raising taxes on those who comply with the law must make up the difference. In the past, the Committee has recommended the hiring of additional interstate auditors to enhance the Department of Revenue's ability to collect out-of-state tax debts that are due but not paid. To further increase the Department's ability to collect this out-of-state tax debt, the 1999 General Assembly in S.L. 1999-341 authorized the Department of Revenue to contract with collection agencies for out-of-state tax debt during the 1999-2001 biennium. The legislation granting the authorization provided funding for the first year. The Department of Revenue provided the Committee with an update on its progress in securing a contract for the collection of these debts. The Department is currently involved in a pilot effort in conjunction with the Office of the State Controller. On March 16, 2000, the Department sent 1,016 accounts with a value of $927,170.46 to the Office of the State Controller for referral to a collection agency. Within the first 30 days, the Department realized a 2.5% return. The Department has learned a number of lessons as a result of the pilot study and, pending funding, plans to move into a full contract later this year. Legislative Proposal 2 provides funding for the second year of the biennium for this contract.

S.L. 1999-341 also directed the Department of Revenue, in cooperation with the Office of the State Controller, to conduct a study of the Department's delinquent collection practices. The Office of the State Controller's existing contract with PricewaterhouseCoopers (PwC) was modified and PwC conducted the study. PwC made the following recommendations to improve the Department's debt collection practices:

- ✓ Implement an automated case management tool with debt scoring and performance measurements. The projected impact is an increase of delinquent tax collection by $11 million to $30 million annually.

- ✓ Centralize the collection process for individual income taxes, installment agreements, low dollar debts, and wage garnishments.
- ✓ Contract with collection agencies for out-of-state debt. The projected impact is an initial $20 million in additional revenues and $3 million in recurring revenues.
- ✓ Contract with collection agencies for long term delinquent accounts. The projected impact is up to $20 million in revenues annually.

To deter taxpayers from filing returns they know to be substantially incorrect, Legislative Proposal 11 provides a civil penalty of $500 for filing a return that is substantially incorrect with a desire to impede the revenue laws of the State. This proposal also gives Revenue Law Enforcement agents authority to enforce several misdemeanor tax statutes, as well as the felony statutes they may currently enforce.

Finally, the Committee studied numerous proposals for technical corrections to the revenue laws raised by the Department of Revenue, taxpayers, and legislative staff. These recommendations are contained in Legislative Proposal 8, providing technical, clarifying, and conforming changes to the revenue laws and related statutes.

As the Revenue Laws Study Committee concluded its work for the 1999-2000 interim, it requested the Secretary of Commerce, Rick Carlisle, to report on the Department of Commerce's progress in reducing the states' use of tax incentives for economic development. The Department sent letters to the State's congressional delegation and to other states' Departments of Commerce asking that the issue of tax incentives for economic development be reviewed. It also received a grant from the U.S. Department of Commerce to study North Carolina's use of tax incentives for economic development. The grant will allow the Department to design a monitoring and evaluation system for the State's economic development program. The Department has purchased an economic impact model to use in estimating the economic benefits of potential new location and expansion projects. The Department hopes to configure the model so that it can also conduct cost-benefit analyses of projects that receive incentives.

A study by the Council of State Governments found that states are slowing down in their use of incentives. However, the Secretary noted that without federal intervention, states are unlikely to unilaterally end the use of incentives for economic development.

The Secretary of Commerce also briefed the Revenue Laws Study Committee on the economic needs of the 25 counties impacted most severely by the hurricanes in 1999. The counties remain in great need of additional housing. Many small businesses continue to benefit from the low interest government loans made available to them after the storms. On the bright side, most of the large businesses have bounded back. The unemployment figures for these 25 counties do not indicate a great shift from the year-to-date figures before the storms. The tier designation formulas under the Bill Lee Act appear to be adequately addressing the economic needs of the State as a whole.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee recommends the following 11 bills to the 2000 Regular Session of the 1999 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.

LEGISLATIVE PROPOSAL 1:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO CONFORM TO FEDERAL LAW REGARDING DEADLINES FOR PAYMENTS OF CERTAIN ESTIMATED INCOME TAXES, AND TO CLARIFY THE SALES FACTOR FOR DETERMINATION OF STATE CORPORATE INCOME AND FRANCHISE TAX.

SHORT TITLE: Conformity with Federal Law.

BRIEF OVERVIEW: The proposal makes three changes to the State's tax laws:

- Rewrites the definition of the Internal Revenue Code used in the State tax statutes to change the reference date from June 1, 1999, to January 1, 2000. Updating the Code reference makes recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law.
- Returns law to conformity with federal, correcting an inadvertent change made in 1985. Federal law forgives the penalty for farmers and fishers' late payment of estimated taxes if the final return is filed, with taxes paid in full, by March 1 following the end of the taxable year. Current law erroneously bases the forgiveness on March 1 payment of estimated tax.
- Amends the definition of "sales" for purposes of the apportionment formula to clarify that the receipts of a multi-state corporation should only include the net gain realized from the sale or maturity of securities, not the rolled over capital or return of principal.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

FISCAL IMPACT: The proposal is expected to generate approximately $1.37 million in fiscal year 1999-2000 and to lose approximately $2.03 million in fiscal year 2000-2001.

EFFECTIVE DATE: The federal tax law changes that could increase an individual's or a corporation's North Carolina taxable income for the 1999 tax year will not become effective for the 1999 tax year but will instead apply only to taxable years beginning on or after January 1, 2000. The remainder of the federal tax law changes are adopted when they become effective under federal law. The provisions conforming the estimated tax deadline and clarifying the sales factor become effective when they become law.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

H/S D

LEGISLATIVE PROPOSAL 1
00-RBXZ-01(4.28)

Short Title: Conform with Federal Law. (Public)

Sponsors: Representatives Luebke; Allen, Gray, Hill, Jarrell, Miller, Pope, and Tucker.

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, TO CONFORM TO FEDERAL LAW REGARDING DEADLINES FOR PAYMENTS OF CERTAIN ESTIMATED INCOME TAXES, AND TO CLARIFY THE SALES FACTOR FOR DETERMINATION OF STATE CORPORATE INCOME AND FRANCHISE TAX.

The General Assembly of North Carolina enacts:

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

"(b) Definitions. -- The following definitions apply in this Article:

. . .

(1a) Code. -- The Internal Revenue Code as enacted as of ~~June 1, 1999,~~ January 1, 2000, including any provisions enacted as of that date which become effective either before or after that date."

Section 2. G.S. 105-163.15(i) reads as rewritten:

"(i) Notwithstanding ~~the other provisions~~ subsections (c), (d), (e), and (h) of this section, an individual who is a farmer or fisherman for a taxable year is subject to the provisions of this subsection.

(1) One Installment. -- The individual is required to make only one installment payment of tax for that taxable 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~~ must be the lesser of:

~~(1)~~ a. 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)~~ b. 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.

(2) Exception. -- If, on or before March 1 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 is imposed under subsection (a) of this section with respect to any underpayment of the required installment for the taxable year.

(3) Eligibility. -- 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."

Section 3. G.S. 105-130.4(a)(7) reads as rewritten:

"(a) As used in this section, unless the context otherwise requires:

...

(7) "Sales" means all gross receipts of the corporation except ~~receipts~~ for the following receipts:

a. Receipts from ~~any~~ a casual sale of ~~property and except receipts~~ property.

b. Receipts allocated under subsections (c) through (h) of this section.

c. Receipts exempt from taxation.

d. The portion of receipts realized from the sale or maturity of securities or other obligations that represents a return of principal."

Section 4. Notwithstanding Section 1 of this bill, any amendments to the Internal Revenue Code enacted in 1999 that increase North Carolina taxable income for the 1999 taxable year become effective for taxable years beginning on or after January 1, 2000.

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

LEGISLATIVE PROPOSAL 1:
Conform with Federal Law

BILL ANALYSIS

Committee:	Revenue Laws	**Introduced by:**	Rep. Luebke
Date:	April 27, 2000	**Summary by:**	Cindy Avrette
Version:	00-RBXZ-01(4.28)		Committee Counsel

SUMMARY: ***Legislative Proposal 1 makes three tax law changes:***

- ***It rewrites the definition of the Internal Revenue Code used in the State tax statutes to change the reference date from June 1, 1999, to January 1, 2000. 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. (Sections 1 and 4)***
- ***It returns law to conformity with federal, correcting an inadvertent change made in 1985. Federal law forgives the penalty for farmers' and fishers' late payment of estimated taxes if the final return is filed, with taxes paid in full, by March 1 following the end of the taxable year. (Section 2)***
- ***It amends the definition of "sales" for purposes of the apportionment formula to clarify that the receipts of a multi-state corporation should only include the net gain realized from the sale or maturity of securities, not the rolled over capital or return of principal. (Section 3)***

UPDATE IRC REFERENCE: Since the General Assembly updated the State's reference to the Internal Revenue Code to June 1, 1999, Congress has enacted Public Law 106-107, the Tax Relief Extension Act of 1999. The Act extends several expired and expiring tax provisions, some of which affect federal taxable income. Since the computation of State taxable income begins with federal taxable income, any changes to federal taxable income affect State taxable income.

Section 1 of the proposal rewrites the definition of the Internal Revenue Code to change the reference date from June 1, 1999, to January 1, 2000. Section 4 of the proposal provides that the federal tax law changes that could increase an individual's or a corporation's North Carolina taxable income for the 1999 tax year will not become effective for the 1999 tax year but will instead apply only to taxable years beginning on or after January 1, 2000. Under Section 16 of Article 1 of the North Carolina Constitution, the legislature cannot pass a law that will retroactively increase the tax liability of any taxpayer. There are a few provisions in the federal tax law changes that could increase taxable income for the 1999 tax year. Because this act could not be ratified until after the 2000 Session of the 1999 General Assembly convened, these changes were given a delayed effective date. A summary of the provisions of th Tax Relief Extension Act that may affect State 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.

In 1997, the Revenue Laws Study Committee explored the possibility of legislation that would automatically adopt federal changes to the Code each year, with legislative review and approval required in the succeeding legislative session. It was hoped that this approach would avoid the practical difficulties that occur when Code changes go into effect many months before the General Assembly has a chance to pass legislation adopting the changes. The Attorney General's Office reviewed the relevant case law in this State and other states before concluding that this approach would be unlikely to withstand a constitutional challenge.

CONFORM ESTIMATED TAX DEADLINE: Section 2 corrects an inadvertent change made in 1985 by conforming the State's estimated tax deadline for farmers and fishers with the federal deadline. Federal law forgives the penalty for farmers and fishers late payment of estimated taxes if the final return is filed, with taxes paid in full, by March 1 following the end of the taxable year. Current law erroneously bases the forgiveness on March 1 payment of estimated tax.

Prior to 1985, the federal and State tax law requirements to pay estimated tax and the imposition of the underpayment penalty were contained in different statutes. In 1984, federal law was rewritten to consolidate several Code sections regarding the payment of estimated tax into one Code section. In 1985, North Carolina enacted similar legislation consolidating the State statutes into one statute. The bill was entitled "AN ACT TO CONFORM PAYMENTS OF NORTH CAROLINA ESTIMATED TAX PENALTIES FOR INDIVIUDUALS TO FEDERAL ESTIMATED TAX PAYMENT PENALTIES." The exceptions were intended to remain the same and the Department of Revenue has administered those exceptions in that manner since the legislation was enacted

CLARIFY SALES FACTOR: A multi-state corporation that has income from business activity which is taxable in more than one state must allocate and apportion a percentage of its income to this State for purposes of the State's corporate income and franchise tax law. An excluded corporation apportions its income to the State by multiplying its income by the sales factor. An excluded corporation is a corporation engaged in business as a building or construction contractor, a securities dealer, a loan company or a corporation which receives more than 50% of its ordinary gross income from investments or dealings in intangible property. The sales factor is a fraction, the numerator of which is the total sales of the corporation in this State during the income year and the denominator of which is the total sales of the corporation everywhere during the income year.

The definition of "sales" is the gross receipts of the corporation except for receipts from a casual sale of property and receipts otherwise allocated by statute, such as rents, royalties, sales of real property, interest, and net dividends. Section 3 further clarifies the definition of "sales" by excluding from gross receipts the following:

- Receipts exempt from taxation.
- The portion of receipts realized from the sale or maturity of securities or other obligations that represents a return of principal.

To include these receipts in the gross amount would distort the sales fraction. For example, it is not unusual for working capital to be turned over repeatedly by investing in short term securities. When the receipts include both principal and interest, the principal may be included in the denominator several times. When the denominator is inflated, the fraction is diluted and it can not accurately reflect the true net earnings of the corporation in North Carolina. This part of the proposal clarifies that only the net gain from the sale or maturity of securities should be included in the sales factor, not the rolled over capital or return of principal and not receipts otherwise exempt from taxation.

Provisions of Federal Tax Relief Extension Act That may affect State Taxable Income

Individual Income Tax

- **Extend Exclusion for Employer-Provided Educational Assistance.** Section 127 of the Code provides an exclusion from gross income of up to $5,250 annually for employer-provided educational assistance for undergraduate courses. The exclusion would have expired with respect to courses beginning or after June 1, 2000. Public Law 106-107 extends the exclusion with respect to courses beginning before January 1, 2002.
- **Denial of Charitable Contribution Deduction for Transfers Associated with Split-Dollar Insurance Arrangements.** Clarifies that no charitable contribution deduction is allowed for a transfer to or for the benefit of a charitable organization if, in connection with the transfer, the organization directly or indirectly pays any premium on any personal benefit contract with respect to the transferor. A personal benefit contract is a life insurance, annuity, or endowment contract. The clarification of this provision does not infer that a charitable split-dollar insurance arrangement was allowed under prior law. It does not apply to a person that benefits exclusively under a bona fide charitable gift annuity within the meaning of the Code.

Individual and Corporate Income Tax

- **Extension of the Work Opportunity Tax Credit and the Welfare-to-Work Tax Credit.** Public Law 106-107 provides a 30-month extension of these two credits. They would have expired for wages paid or incurred to a qualified individual who began work for an employer before July 1, 1999. To the extent an employer claims the federal credit, the employer must reduce its federal deduction for wages by the amount of the credit. Since North Carolina does not have comparable credits, it allows a taxpayer who claims the federal credits to claim a deduction from federal taxable income for the amount by which the employer's deduction for wages was reduced.
- **Extend Expensing of Environmental Remediation Expenditures.** Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. Eligible expenditures are those paid or incurred before January 1, 2002, as opposed to January 1, 2001.
- **Federal Production Payments to Farmers.** A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. Public Law 106-107 provides that an option to accelerate the receipt of a payment under a production flexibility contract will not accelerate the recognition of income. The contract payments are to be included in gross income in the year they are actually received. A production flexibility contract is between the Secretary of Agriculture and farmers. The contracts generally cover crop years 1996 through 2002.

- **Prohibition on Use of the Installment Method by Accrual Method Taxpayers.** An accrual method taxpayer is generally required to recognize income when all the events have occurred that fix the right to the receipt of the income and the amount of the income can be determined with reasonable accuracy. Prior to the enactment of Public Law 106-107, the installment method of accounting provided an exception to this general principle of income recognition. The installment method of accounting allows a taxpayer to defer the recognition of income from the disposition of certain property until payment is received, regardless of whether the taxpayer uses the cash method or accrual method of accounting. Public Law 106-107 generally prohibits the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting. It retains the present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming and for dispositions of timeshares or residential lots if the taxpayer elects to pay interest under section 453(l). It does not change the ability of a cash method taxpayer to use the installment method.
- **Clarify the Tax Treatment of Income and Losses on Derivatives.** Three categories have been added to the list of assets the gain or loss on which is treated as ordinary income, as opposed to a capital gain or loss. The new categories are: commodities derivatives held by commodities derivatives dealers; hedging transactions; and supplies of a type regularly consumed by the taxpayer in the ordinary course of the taxpayer's trade or business.
- **Limit Conversion of Character of Income from Constructive Ownership Transactions.** Public Law 106-107 limits the amount of long-term capital gains a taxpayer can recognize from derivative transactions with respect to certain pass-through entities to the amount of gain the taxpayer would have had if the taxpayer owned a direct interest in the pass-through entity during the term of the derivative contract.
- **Treatment of Excess Pension Assets used for Retiree Health Benefits.** The period of time permitting qualified transfers of excess defined benefit pension plan assets to retiree health benefits accounts under section 401(h) has been extended to include transfers that take place prior to January 1, 2006. It would have expired on December 31, 2000.

Corporate Income Tax

- **Distributions by a Partnership to a Corporate Partner of Stock in Another Corporation.** Public Law 106-107 allows a basis reduction to assets of a corporation if stock in that corporation is distributed by a partnership to a corporate partner. The reduction applies if, after the distribution, the corporate partner controls the distributed corporation.
- **Extend Exceptions under Subpart F for Active Financing Income.** A foreign corporation is a "Controlled Foreign Corporation" if more than 50% of its outstanding voting stock, or more than 50% of the value of all its outstanding stock, is owned by US shareholders. A "US shareholder" is a US person who owns 10% or more of the foreign corporation's total combined voting stock.

  In general, the foreign-source income of a foreign corporation is not taxable to its US shareholders until it is distributed to them. Recognizing that income could be accumulated in a CFC, thus deferring US tax on this income indefinitely, Congress enacted the subpart F provisions of the Code in 1962. These provisions require certain items of income to be treated as deemed paid to US shareholders and, therefore, subject to US taxation. The income subject to current inclusion under the subpart F rules includes foreign personal holding company income, insurance income, and foreign

base company services income. Examples of foreign personal holding company income include dividends, rents, royalties, annuities, net gains from commodity transactions, net gains from foreign currency transactions, and payments in lieu of dividends. Insurance income subject to inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Foreign base company services income is income derived from services performed for a related person outside the country in which the CFC is organized.

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business. These exceptions were set to expire on December 31, 1999. Public Law 106-107 extended these exceptions for two years.

FISCAL ANALYSIS MEMORANDUM

DATE: April 28, 2000

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal 1
Conform with Federal Law

FISCAL IMPACT

Yes (x) **No ( )** **No Estimate Available ( )**

($ million)

	FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04
REVENUES					
General Fund					
Conform Tax Deadline		No fiscal impact			
Clarify Sales Factor		No fiscal impact			
IRC Update	1.37	-2.03	-4.35	.65	.85

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

EFFECTIVE DATE: The act is effective when it becomes law.

BILL SUMMARY: Section one of the bill updates the reference to the Internal Revenue Code used in state tax provisions from June 1, 1999 to January 1, 2000. Section two conforms state statutes with federal law regarding deadlines for payments of certain estimated income taxes. Section three clarifies in the corporate apportionment formula that receipts of a multistate corporation should only include the net gain realized from the sale or maturity of securities, not the rolled over capital or return of principal.

ASSUMPTIONS AND METHODOLOGY:

Conform Estimated Tax Deadline

There is no fiscal impact of this section because it codifies the administrative practice of the Department of Revenue. This section recognizes the federal forgiveness of penalties for late payment of estimated taxes by farmers and fishermen if the final return is filed, with taxes paid in full, by March 1 following the end of the taxable year. Even though the state law has been out of conformity with the federal law since 1985, state administrators and tax preparers have been following the federal law.

Clarify Sales Factor

There is no fiscal impact of this section because it codifies the administrative practice of the Department of Revenue. The Department believes that "gross receipts for the purpose of computing the sales factor should only include net gain, and not the rolled over capital or return of principal, realized from the sale or maturity of securities." A New York securities firm has filed a protest of this departmental interpretation. The North Carolina Attorney General ruled in favor of the Department on a similar issue in 1983, but has not issued an official opinion on this exact topic. While passage of this section has no fiscal impact, failure to approve this measure and clarify the sales factor in the statute, puts the state at risk of losing a minimum of $3 million a year. This estimate is based on a limited review of audit cases and protests by the Department of Revenue's Corporate, Excise and Insurance Tax Division.

IRC Update

Since North Carolina individual and corporate income tax tracks the federal income tax law, it is necessary each year to update state statutory references to the Internal Revenue Code (I.R.C.). President Clinton signed the Tax Relief Extension Act of 1999 into law on December 17, 1999. Department of Revenue officials and legislative staff have determined that some of the provisions in this act have an impact on the state's tax laws. The attached chart shows the fiscal impact of the bill based on estimates by the Congressional Joint Committee on Taxation. The North Carolina percentage of the national estimate is based on actual tax collections. The national estimates are further adjusted for the state fiscal year.

Tax Relief Extension Act of 1999 - Impact on General Fund

	Fiscal Year ($ Millions)										
	Effective Date	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Individual Income Tax											
Extend exclusion for employer-provided education assistance through 12/31/01	05/31/2000		-1.15	-2.30	-0.95						
Deny charitable contribution deduction for transfers associated with split-dollar insurance arrangements	02/08/1999	Negligible Revenue Effect									
Individual and Corporate Income Tax											
Extend the work opportunity and the welfare to work tax credits through 12/31/01	06/30/1999	-0.30	-0.43	-0.40	-0.21	-0.08	-0.03	-0.01			
Extend expensing of environmental remediation expenditures through 12/31/01	12/17/1999		-0.23	-0.32	-0.11	-0.01	-0.01	0.01	0.03	0.03	0.04
Provide that Federal Farm Production Payments are taxable in the year of receipt	12/17/1999	Negligible Revenue Effect									
Prohibit the use of the installment method by accrual method taxpayers	iso/a 12/17/1999	2.59	3.67	2.20	1.39	0.39	0.04	0.11	0.19	0.26	0.34
Clarify the tax treatment of income and losses on derivatives	12/17/1999	0.00	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Limit conversion of character of income from constructive ownership transactions	teio/a 7/12/1999	0.08	0.24	0.25	0.27	0.28	0.29	0.31	0.34	0.36	0.38
Allow employers to transfer excess pension assets used for retiree health benefits through 12/31/05	tmi tyba 12/31/2000		0.10	0.21	0.21	0.22	0.23	0.12			
Corporate Income Tax											
Reduce basis in assets for distributions by a partnership to a corporate partner of stock in another corporation	07/14/1999	0.01	0.02	0.04	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Extend exceptions under subpart F for active financing income through 12/31/01	tyba 12/31/1999	-1.014	-4.255	-4.032							
Total General Fund Impact		1.37	-2.03	-4.35	0.65	0.85	0.60	0.62	0.61	0.71	0.82

NOTES:

1) North Carolina estimates are based on a percentage of the federal estimate calculated by the Congressional Joint Committee on Taxation. The percentage used is N.C. actual tax collections divided by national tax collections. (Individual = .723% Corporate = .542%)

iso/a = installment sales on or after

teio/a = transactions entered into on or after

tmi = transfers made in

tyba = taxable year beginning in

LEGISLATIVE PROPOSAL 2:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO IMPLEMENT THE RECOMMENDATION OF THE NATIONAL GOVERNOR'S ASSOCIATION FOR A STREAMLINED SALES TAX COLLECTION SYSTEM AND TO OTHERWISE IMPROVE COLLECTION.

SHORT TITLE: Streamlined Sales Tax System.

BRIEF OVERVIEW: It seeks to improve the State's sales and use tax collections in several ways:

- It simplifies and streamlines the sales and use tax collection system for remote and in-state retailers.
- It provides that a remote seller who does not agree to collect the State's use tax may not use the State's courts to collect debts owed to it by a purchaser of its product in this State.
- It allows the Department of Revenue to exchange information concerning a taxpayer's social security number with DMV.
- It provides the Department of Revenue with resources to continue its collection of delinquent tax debts owed by nonresidents and foreign entities and to develop a performance-based contract for a more automated collection system.

FISCAL IMPACT: See fiscal note.

EFFECTIVE DATE: The provision expanding the penalty for misusing exemption documents becomes effective January 1, 2001. The remainder of the proposal is effective when it becomes law.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

H D

LEGISLATIVE PROPOSAL 2
(00-RBXZ-02(4.25))

Short Title: Streamlined Sales Tax System. (Public)

Sponsors: Representatives Miller; Allen, Gray, Hill, Jarrell, Luebke, Pope, and Tucker.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO IMPLEMENT THE RECOMMENDATION OF THE NATIONAL GOVERNOR'S ASSOCIATION FOR A STREAMLINED SALES TAX COLLECTION SYSTEM AND TO OTHERWISE IMPROVE COLLECTION.

The General Assembly of North Carolina enacts:

Section 1. Article 5 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-164.27. Direct pay certificate.**

(a) Requirements. -- A person who purchases tangible personal property whose tax status cannot be determined at the time of the purchase because of one of the reasons listed below may apply to the Secretary for a direct pay certificate:

(1) The place of business where the property will be used is not known at the time of the purchase and a different tax consequence applies depending on where the property is used.

(2) The manner in which the property will be used is not known at the time of the purchase and one or more of the potential uses is taxable but others are not taxable.

(b) Procedure. -- An application for a direct pay certificate must be made on a form provided by the Secretary

and contain the information required by the Secretary. The Secretary may grant the application if the Secretary finds that the applicant complies with the sales and use tax laws and that the applicant's compliance burden will be greatly reduced by use of the certificate.

(c) Effect. -- A direct pay certificate authorizes its holder to purchase any tangible personal property without paying tax to the seller and authorizes the seller to not collect any tax on a sale to the certificate holder. A person who purchases tangible personal property under a direct pay certificate is liable for use tax due on the purchase. The tax is payable when the property is placed in use. A direct pay certificate does not apply to taxes imposed under G.S. 105-164.4(a)(1f) or 105-164.4(a)(4a).

(d) Revocation. -- A direct pay certificate is valid until the holder returns it to the Secretary or it is revoked by the Secretary. The Secretary may revoke a direct pay certificate if the holder of the certificate does not file a sales and use tax return on time, does not pay sales and use on time, or otherwise fails to comply with the sales and use tax laws."

Section 2. Article 5 of Chapter 105 of the General Statutes is amended by adding the following new sections to read:

"**§ 105-164.43A. Certification of tax collector software and tax collector.**

(a) Software. -- The Secretary may certify a software program as a certified sales tax collection program if the Secretary determines that the program correctly determines all of the following and that the software can generate reports and returns required by the Secretary:

(1) The applicable combined State and local sales and use tax rate for a sale, based on a ship-to address.

(2) Whether or not an item is exempt from tax, based on a uniform product code or another method.

(3) Whether or not an exemption certificate offered by a purchaser is a valid certificate, based on the Department's registry of holders of exemption certificates.

(4) The amount of tax to be remitted for each taxpayer for a reporting period.

(5) Any other issue necessary for the application or calculation of sales and use tax due.

(b) Tax Collector. -- The Secretary may certify an entity as a Certified Sales Tax Collector if the entity meets all of the following requirements:

(1) The entity uses a certified sales tax collection program.

(2) The entity has agreed to update its program upon notification by the Secretary.

(3) The entity integrates its certified sales tax collection program with the system of a retailer for whom the entity collects tax so that the tax due on a sale is determined at the time of the sale.

(4) The entity remits the taxes it collects at the time and in the manner specified by the Secretary.

(5) The entity agrees to file sales and use tax returns on behalf of the retailers for whom it collects tax.

(6) The entity enters into a contract with the Secretary and agrees to comply with all the conditions of the contract.

"**§ 105-164.43B. Contract with Certified Sales Tax Collector.**

The Secretary may contract with a Certified Sales Tax Collector for the collection and remittance of sales and use taxes. The amount a Certified Sales Tax Collector charges under the contract is a cost of collecting the tax and is payable from the amount collected.

"**§ 105-164.43C. Effect of contract.**

(a) Retailer. -- A retailer who contracts with a Certified Sales Tax Collector is not subject to audit by the State on the transactions it processes using the Collector's certified sales tax collection program. A retailer is subject to audit for transactions not processed by the Certified Sales Tax Collector.

The Department may review a retailer's procedures to determine if the certified sales tax collection program is functioning properly. A retailer who contracts with a Certified Sales Tax Collector is not liable for taxes due on sales processed using the program unless the retailer misrepresented the product it sells. A contract with a Certified Sales Tax Collector is not a factor in determining whether a person has nexus with this State for payment of any tax.

(b) Collector. -- A Certified Sales Tax Collector is the agent of a seller who contracts with the Certified Sales Tax Collector for collection and remittance of sales and use taxes payable to this State. As the seller's agent, the Certified Sales Tax Collector is liable for sales tax due on all sales transactions processed by the Certified Sales Tax Collector unless the seller misrepresented the type of property sold."

Section 3. G.S. 105-88(d) reads as rewritten:

"(d) A loan made by a person who does not comply with this section is not collectible at law ~~in the courts of this State in any case where the person making the loan has failed to pay the tax levied in this section or otherwise failed to comply with the provisions of this section.~~ under G.S. 105-269.13."

Section 4. G.S. 105-164.6A(b)(1) reads as rewritten:

"(b) Mandatory Provisions. -- The agreements must contain the following provisions:

.....

(1) ~~The customer may elect to pay the use tax directly to the Secretary in accordance with law rather than to the seller.~~ The seller is not liable for use tax not paid to it by a customer."

Section 5. G.S. 105-164.13 is amended by adding a new subdivision to read:

"**§ 105-164.13. Retail sales and use tax.**

The sale at retail, the use, storage or consumption in this State of the following tangible personal property is specifically exempted from the tax imposed by this Article:

.....

(16a) Tangible personal property sold to a person in the State but delivered to a person in another state."

Section 6. G.S. 105-164.28 reads as rewritten:

"**§ 105-164.28. Certificate of resale.**

(a) Seller's Responsibility. -- A seller who accepts a certificate of resale from a purchaser of tangible personal property has the burden of proving that the sale was not a retail sale unless all of the following conditions are met:

(1) ~~The seller acted in good faith in accepting the certificate of resale.~~ For a sale made in person, the certificate is signed by the purchaser, states the purchaser's name, address, and registration number, and describes the type

of tangible personal property generally sold by the purchaser in the regular course of business.

(2) ~~The certificate is in the form required by the Secretary.~~ For a sale made in person, the purchaser is engaged in the business of selling tangible personal property of the type sold.

(3) ~~The certificate is signed by the purchaser, states the purchaser's name, address, and registration number, and describes the type of tangible personal property generally sold by the purchaser in the regular course of business.~~ For a sale made over the Internet or by other remote means, the sales tax registration number given by the purchaser matches the number on the Department's registry.

~~(4) The purchaser is licensed under this Article or under the law of another taxing jurisdiction.~~

~~(5) The purchaser is engaged in the business of selling tangible personal property of the type sold.~~

(b) Liabilities. -- A purchaser who does not resell property purchased under a certificate of resale is liable for any tax subsequently determined to be due on the sale. A seller of property sold under a certificate of resale is jointly liable with the purchaser of the property for any tax subsequently determined to be due on the sale only if the Secretary proves that the sale was a retail sale."

Section 7. G.S. 105-236(5a) reads as rewritten:

"(5a) Misuse of Exemption ~~Certificate of Resale.~~ Certificate. -- For misuse of ~~a certificate of resale~~ an exemption certificate by a purchaser, the Secretary shall assess a penalty equal to two hundred fifty dollars ($250.00). An exemption certificate is a certificate issued by the Secretary that authorizes a retailer to sell tangible personal property to the holder of the certificate and either collect tax at a preferential rate or not collect tax on the sale. Examples of an exemption certificate include a certificate of resale, a direct pay certificate, and a farmer's certificate."

Section 8. 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:

....

(25) To provide public access to a database containing the names of retailers who are registered to collect sales and use taxes under Article 5 of this Chapter."

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

"**§105-269.13. Debts not collectible under North Carolina law.**

(a) Debts Not Collectible. -- The following debts are not collectible and are not subject to execution under Article 28 of Chapter 1 of the General Statutes or any other provision of law:

(1) A loan made by a person who does not comply with G.S. 105-88.

(2) A debt owed to a retailer described in subsection (b) of this section as the result of the purchase of tangible personal property.

(b) Retailer. -- A debt owed to a retailer is subject to this section if all of the following applies to the retailer:

(1) The retailer meets one or more of the conditions in G.S. 105-164.8(b).

(2) The retailer is not registered to collect the use tax due under Article 5 of this Chapter on its sales delivered to an address in North Carolina.

(3) The retailer reported gross sales of at least five million dollars ($5,000,000) on its most recent federal income tax return."

Section 10. G.S. 105-466 reads as rewritten:

"(c) Collection of the tax, and liability therefor, shall begin and continue only on and after the first day of ~~a calendar month~~ the month of either January or July, as set by the board of county commissioners in the resolution levying the ~~tax, which shall in no case be~~ tax. In no event may the tax be imposed, or the tax rate changed, earlier than the first day of the second succeeding calendar month after the date of the adoption of the resolution. The county must give

the Secretary at least 90 days advance notice of a new tax levy or tax rate change."

Section 11. Chapter 1096 of the 1967 Session Laws is amended by adding a new section to read:

"Section 10.3. Mecklenburg County must give the Secretary of Revenue at least 90 days advance notice of any tax rate change under this act. Any tax rate change under this act must become effective on the first day of the month of either January or July, as set by the board of county commissioners in the resolution levying the tax.

Section 12. G.S. 20-7(b1) reads as rewritten:

"**§ 20-7. Issuance and renewal of drivers licenses.**

(b1) Application. -- To obtain a drivers license from the Division, a person must complete an application form provided by the Division, present at least two forms of identification approved by the Commissioner, be a resident of this State, and demonstrate his or her physical and mental ability to drive safely a motor vehicle included in the class of license for which the person has applied. The Division may copy the identification presented or hold it for a brief period of time to verify its authenticity. To obtain an endorsement, a person must demonstrate his or her physical and mental ability to drive safely the type of motor vehicle for which the endorsement is required.

The application form must request all of the following ~~information:~~ information and it must contain the disclosures concerning the request for an applicant's social security number required by section 7 of the federal Privacy Act of 1974, Pub. L. No. 93-579:

(1) The applicant's full name.

(2) The applicant's mailing address and residence address.

(3) A physical description of the applicant, including the applicant's sex, height, eye color, and hair color.

(4) The applicant's date of birth.

(5) The applicant's social security number. The Division shall not issue a license to an applicant who fails to provide the applicant's social security number. ~~The applicant's social security number shall not be printed on the license and may be released only to the Department of Health and Human Services, Child Support Enforcement Program, upon its request~~

~~and for the purpose of establishing paternity or child support, or enforcing a child support order.~~

(6) The applicant's signature.

~~The application form must also contain the disclosures concerning the request for an applicant's social security number required by section 7 of the federal Privacy Act of 1974, Pub. L. No. 93-579.~~

(b2) Disclosure of Social Security Number. -- The social security number of an applicant is not a public record. The Division may not disclose an applicant's social security number except as allowed under federal law. A violation of the disclosure restrictions is punishable as provided in 42 U.S.C. 408, and amendments to that law.

In accordance with 42 U.S.C. 405 and 42 U.S.C. 666, and amendments thereto, the Division may disclose a social security number obtained under ~~this subsection~~ subsection (b1) of this section only as follows:

(1) ~~for~~ For the purpose of administering the drivers license ~~laws or to~~ laws.

(2) To the Department of Health and Human Services, Child Support Enforcement Program for the purpose of ~~assist the State Child Support Enforcement Program in~~ establishing paternity or ~~establishing~~ child support or enforcing a child support order. ~~and may not disclose the social security number for any other purpose. The social security number of an applicant for a license or of a licensed driver is therefore not a public record. A violation of the disclosure restrictions is punishable as provided in 42 U.S.C. 408, and amendments thereto.~~

(3) To the Department of Revenue for the purpose of verifying taxpayer identity."

Section 13. G.S. 20-7(n)(7) reads as rewritten:

"(n) Format. -- A drivers license issued by the Division must be tamperproof and must contain all of the following information:

...

(7) ~~The license holder's social security number or another~~ An identifying number for the license holder assigned by the Division. The identifying number may not be the license holder's social security number."

Section 14. Section 5.(a) of Chapter 341 of the 1999 Session Laws reads as rewritten:

"Section 5.(a) The Secretary of Revenue shall contract during the 1999-2001 fiscal biennium for the collection of delinquent tax debts owed by nonresidents and foreign entities. To implement this section, the Secretary may draw funds for the 1999-2000 fiscal year from net collections that would otherwise be credited to the General Fund under G.S. 105-269.14, enacted by Section 2 of this act. For the 2000-2001 fiscal year, the Secretary may retain the costs of implementing this section from the amounts collected pursuant to the contracts authorized by this section. The Secretary of Revenue shall report annually to the Revenue Laws Study Committee on its collections pursuant to this contract during the biennium."

Section 15. Section 6 of Chapter 341 of the 1999 Session Laws reads as rewritten:

"Section 6. The Department of Revenue shall conduct a study to identify and evaluate proposals for more efficient collection of taxes, including using electronic commerce and other technology to increase efficiency. The study shall include an analysis of the most efficient tax collection methods used in other states. The State Controller shall cooperate with the Department of Revenue in this study. The Department shall report the results of its study, including findings, recommendations, and estimated revenue gains of each recommendation, to the Revenue Laws Study Committee by May 1, 2000. To implement this section, the Secretary of Revenue may draw up to fifty thousand dollars ($50,000) for the 1999-2000 fiscal year from net collections that would otherwise be credited to the General Fund under G.S. 105-269.14, enacted by Section 2 of this act. To implement the recommendations of this study, the Secretary may enter into a performance based contract and may draw up to five hundred thousand dollars ($500,000) for the 2000-2001 fiscal year from the revenue collected pursuant to section 5 of this act to obtain assistance in developing a request for proposal for the performance based contract."

Section 16. Section 7 of this act becomes effective January 1, 2001. The remainder of this act is effective when it becomes law.

LEGISLATIVE PROPOSAL 2: Streamline Sales Tax System

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Introduced by:**	Rep. Miller
		Summary by:	Cindy Avrette Committee Counsel
Date:	April 27, 2000		
Version:	00-RBXZ-02(4.25)		

SUMMARY: ***Legislative Proposal 2 seeks to improve the State's sales and use tax collections in several different ways:***

- ***It simplifies and streamlines the sales and use tax collection system for remote and in-state retailers.***
- ***It provides that a remote seller who does not agree to collect the State's use tax may not use the State's courts to collect debts owed to it by a purchaser of its product in this State.***
- ***It allows the Department of Revenue to exchange information concerning a taxpayer's social security number with the Division of Motor Vehicles when it is necessary to identify a taxpayer.***
- ***It provides the Department of Revenue with the resources to continue its collection of delinquent tax debts owed by nonresidents and foreign entities for the remainder of this biennium.***
- ***It authorizes the Department of Revenue to retain up to $500,000 in revenues to obtain assistance in developing a performance-based contract, pursuant to a recommendation from the study by the Department and the State Controller on how to more efficiently collect taxes.***

With the exception of section 7, the proposal becomes effective when it becomes law. Section 7 becomes effective January 1, 2001.

BACKGROUND: Over the past few years, several different tax policy groups have considered the difficulty of administering and collecting sales and use taxes, especially on purchases made out-of-state. The issues surrounding the collection of use tax on out-of-state purchases are complex. There are numerous tax jurisdictions with many different rates and exemptions. To collect sales and use taxes for different jurisdictions means that multi-state businesses would have to file many different returns and be subject to audits by all of those jurisdictions.

Sales tax simplification is the consistent recommendation of all the various tax policy groups, including the Advisory Commission on Electronic Commerce, the Multistate Tax Commission, the Federal Tax Administrators, the National Tax Association, the Committee on State Taxation, the Institute of Professionals in Taxation, the American Institute of Certified Public Accountants, and the Tax Executives Institute. The 1999 General Assembly enacted several sales tax simplification initiatives: a database for exempt taxpayers, repeal of the $15 registration fee which enables on-line or centralized registration, and electronic filing for semimonthly taxpayers.

On the issue of use tax collection on purchases from remote retailers, the National Governor's Association supports a simplified collection system that shifts sales tax administration from remote,

out-of-state retailers to a technology-oriented business model administered by a "certified sales tax collector". To use this approach requires legislation certifying a model and a sales tax collector. For the model to work, the sales tax laws across the country will need to be more uniform. The proposal builds upon the legislation enacted last session by further simplifying our State's sales tax laws in an effort to meet the uniformity requirements recommended by the NGA, and supported by the following groups: the National Conference of State Legislatures, the Council of State Governments, the International City/County Management Association, the National Association of Counties, the National League of Cities, the U.S. Conference of Mayors, the Federal Tax Administrators, and the Multistate Tax Commission.

BILL ANALYSIS: The proposed legislation seeks to improve tax collection through five different legislative changes.

Streamlined Sales Tax Collection System:

Sections 1, 2, 4-8, 10, and 11 of the proposal implement the streamlined sales tax collection system recommended by the National Governor's Association. The NGA's recommendation shifts sales tax administration to a technology-oriented business model where the primary responsibility for calculating, collecting, reporting, and paying the use tax lies with a "Certified Sales Tax Collector" rather than a remote retailer. Under the system, the State assumes the responsibility for the costs of the system by reimbursing the Collector for the costs of operating the system and for the costs of integrating the system with those of participating retailers. A participating retailer will not be charged for participating in the streamlined sales tax collection program and a retailer's participation in the program is voluntary.

The Certified Sales Tax Collector is the primary component in the streamlined sales tax collection system. Participating states may enter into contracts with a Collector to collect and remit sales and use taxes. The amount a Collector may charge under a contract is considered a cost of collecting the tax and is payable from the amount collected. The payments to the Collector will be made on a per transaction basis based on negotiated rates. The per transaction fee could be in the form of a flat per transaction rate, a percentage rate, or a combination of the two types of rates.

A Certified Sales Tax Collector will use a certified software program to determine the applicable State and local tax due on a transaction. A participating retailer must agree to let the Collector integrate the software with its system so that the tax due on a sale can be determined at the time of the sale. The software will determine the taxability of a transaction, the appropriate tax rate, and the amount of tax due. The information on the amount of tax due will be available to a customer before completion of a transaction. Once the customer approves the purchase, the retailer will send the transaction through the payment processing system and the amount paid to the retailer will be the full amount of the purchase plus tax. A participating retailer will be required to enter into a standing debit authorization agreement with the Collector that will enable the Collector to debit the retailer's account on an agreed upon schedule for the amount of tax owed all participating states according to transactions processed by the Collector.

The Collector will be liable for remitting the appropriate tax to the participating states. The participating retailer will not be subject to audits by the states on the transactions it processes using the Collector's software program. A contract with a Collector will not be a factor in considering whether a person has nexus with a state for payment of a tax.

It is anticipated that the identity of the Certified Sales Tax Collector may vary depending upon the type of retailer involved. Certain large retailers may choose to act as their own Collector. To be a Collector, the Secretary of Revenue must certify an entity. The Secretary may certify an entity as a Certified Sales Tax Collector if the entity meets all of the following conditions:

- Uses a sales tax collection software program certified by the Secretary. To be certified by the Secretary, the program must be able to determine the applicable tax rate based on a ship-to address, determine whether or not an item is exempt from tax, determine whether or not an exemption certificate is valid, calculate the tax due, and generate the reports and returns required by State law.
- Agrees to update its certified software program upon notification by the Secretary.
- Integrates the certified software program with the retailer's system for which the entity collects the tax.
- Remits the tax due and files the necessary returns on behalf of the retailers for whom the entity collects the tax.
- Enters into a contract with the Secretary and agrees to comply with the conditions of the contract.

To participate in this streamlined sales tax collection system, this proposal authorizes the Secretary of Revenue to certify a sales tax collection software program and a sales tax collector. (Section 2) The proposal also makes the following statutory changes to meet the uniformity features needed to successfully implement the streamlined sales tax collection system:

- It makes the exemption process easier to administer by eliminating the "good faith" requirement when accepting an exemption certificate number from a purchaser on a sale made over the Internet or by other remote means. (Section 6) It codifies a long-standing practice of the Department of Revenue to issue "direct pay certificates" to a person who is unsure how property the person purchases should be taxed at the time the property is purchased. (Section 1) And it provides that, effective January 1, 2001, the penalty for misusing an exemption certificate applies not only to a certificate of resale, but also to a direct pay certificate and a farmer's certificate. (Sections 7 and 16)
- It establishes a uniform sourcing rule that calculates the amount of tax due on a sale based on its "ship-to address". (Section 2) Under that rule, property sold to a person in NC but delivered to a person in another state is exempt from NC sales and use tax. (Section 5)
- It provides that the customer of a retailer who participates in the program must pay the sales and use tax on the item purchased. (Section 4)
- It provides that local government sales and use tax rate changes may only be made twice a year and the local government must give the State at least 90 days notice of any tax rate change. (Sections 10 and 11)

Use of NC Courts by Out-of-State Retailers:

Under current law, a loan made by a person who fails to pay or comply with the State privilege tax statute, G.S. 105-88, may not be collected through the State's courts. The proposal extends this

exclusion to include debts owed to a retailer who is required by G.S. 105-164.8(b) to collect use tax for the State but refuses to do so if the retailer reported gross sales of at least $5,000,000 on its most recent federal income tax return. (Sections 3 and 9) A retailer is required to collect use tax for the State under G.S. 105-164.8(b) if the retailer maintains retail offices in the State, has representatives in the State who solicit business, or purposefully and systematically exploits the market in this State by any media-assisted means such as direct mail advertising, distribution of catalogs, computer-assisted shopping, television, radio, etc.

DMV Disclose Social Security Number to DOR:

Under federal law, 42 U.S.C. 405(c)(2)(C), a state may use a person's social security number for the purpose of identification in the administration of its tax laws. The Department of Revenue has used social security numbers to identify taxpayers for many years. Up until recently, the Department was able to obtain a taxpayer's social security number from the Division of Motor Vehicles. The Department may have asked the Division for a taxpayer's social security number when the Department had more than one number on file for a taxpayer and needed to know which number was correct, or when it needed to locate a taxpayer. The exchange of information between the Division and the Department was not addressed by statute. In 1997, the General Assembly amended the drivers license law to require all applicants for a driver's license to provide their social security numbers. The legislation gave specific authority for the Division to disclose social security numbers to the Child Support Enforcement Program. The law did not address the disclosure of the numbers to the Department of Revenue. As a result, the practice between the Division and the Department has stopped.

The proposal rewrites the drivers license statute pertaining to social security numbers to allow the Division to disclose a social security number to the Department for the purpose of verifying taxpayer identification. (Section 12) It also provides that the Division of Motor Vehicles may not use an applicant's social security number as the identifying number for the license holder. (Section 13) This clarification resolves a conflict between two subsections in G.S. 20-7: subsection (b1) provides that an applicant's social security number may not be printed on the license, while subsection (n) says that the license holder's social security number may be the license holder's identifying number.

Contract for Collection of Delinquent Tax Debts:

Last session, the General Assembly allowed the Department of Revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities. A delinquent tax debt is the amount of tax due as stated in a final notice of assessment issued to the taxpayer when the taxpayer no longer has the right to contest the debt. The legislation stated that "[T]he Secretary of Revenue shall contract during the 1999-2001 fiscal biennium for the collection of delinquent tax debts ..." However, the legislation provided a funding mechanism for only the first year of the biennium. The proposal provides funding for the second year of the biennium. It allows the Secretary to retain the costs of the contracts from the amounts collected under the contracts. (Section 14)

The Department is currently involved in a pilot effort to contract for the collection of out-of-state accounts in conjunction with the Office of the State Controller. On March 16, 2000, the Department sent 1016 accounts with a value of $927,170.46 to the Office of the State Controller for referral to a collection agency. Within the first 30 days, the Department realized a 2.5% return.

Funding for Performance-Based Contract:

Last session, the General Assembly authorized the Department of Revenue and the Office of the State Controller to conduct a study of the Department's delinquent collection practices and present findings and recommendations to the Revenue Laws Study Committee. The Office of the State Controller's existing contract with PricewaterhouseCoopers (PwC) was modified and PwC conducted the study. PwC made the following recommendations to improve the Department's debt collection practices:

- ✓ Implement an automated case management tool with debt scoring and performance measures. The projected impact of this recommendation would be an increase of delinquent tax collections by $11 million to $30 million annually.
- ✓ Centralize the collection process for individual income taxes, installment agreements, low dollar debts, and wage garnishments. The impact of this recommendation would be a more efficient use of the Department's resources.
- ✓ Contract with collection agencies for out-of-state debt. The impact of this recommendation would be an initial $20 million in additional revenues and $3 million in recurring revenues.
- ✓ Contract with collection agencies for long term delinquent accounts. The impact of this recommendation would be up to $20 million in revenues per year.

The Department would like to implement the recommendations of this study. To centralize its collection process, the Department would like to enter into a performance-based contract where the person who provides the automated system would be paid from the proceeds of the system based upon some variable that pertains to how well the system works. To enable the Secretary of Revenue to obtain assistance in developing a request for proposal for the performance-base contract, the proposal allows the Secretary to draw up to $500,000 from the revenue collected pursuant to the contracts for the collection of delinquent tax debts owed by nonresidents and foreign entities. (Section 15)

FISCAL ANALYSIS MEMORANDUM

DATE: April 11, 2000

TO: Revenue Laws Study Committee

FROM: Dave Crotts
Fiscal Research Division

RE: Legislative Proposal 2
Streamline Sales Tax System (00-RBXZ-02 (4.25)

FISCAL IMPACT

Yes (x) **No ( )** **No Estimate Available (x)**

GENERAL FUND REVENUE (STATE AND LOCAL): See "Assumptions and Methodology" section.

PRINCIPAL DEPARTMENT AFFECTED: The sales and use tax is collected by the Department of Revenue.

EFFECTIVE DATE: The sales tax exemption certificate provision becomes effective January 1, 2001. The remainder of the bill becomes effective when it becomes law.

ISSUE BACKGROUND: The objective of the proposal is to assist in the implementation of a system to simplify and streamline the sales and use tax collection system for remote and in-state retailers. This would be accomplished by shifting sales tax administration to a technology-oriented business model where the primary responsibility for calculating, collecting, reporting, and remitting the use tax lies with a "Certified Sales Tax Collector" instead of the remote retailer. The State would reimburse the Collector for the costs of integrating the system with a vendor's system and for operating the system. The costs of the system would be funded from the receipts collected and could be recovered through a flat transaction fee, a percentage rate, or some combination.

To participate in the program the Collector must use a certified software program to determine the state and local tax due on a transaction. The participating retailer will not be subject to state audit on the transactions it processes using the Collector's software. Finally, a contract with a Collector is not a factor in establishing nexus for state tax purposes.

EXPLANATION OF PROPOSAL:

(1) Eliminates the "good faith" requirement when accepting an exemption certificate from a purchaser on a sale made over the Internet or by other remote means.

(2) Codifies a long-standing practice of the Department of Revenue to issue "direct pay certificates" to a person who is unsure how the property purchased should be taxed at the time of the acquisition.

(3) Provides that the penalty for misusing an exemption certificate applies not only to a resale certificate but also to a direct pay certificate and a farmer's certificate.

(4) Establishes a uniform sourcing rule that calculates tax due based on a "ship-to address".

(5) Provides that the customer of a retailer who takes part in the new system must pay the sales and use tax on the item purchased.

(6) Provides that local sales tax rate changes may be made no more than twice a year and at least 90 days notice must be given to the Department before a rate change can be made.

(7) Prohibits the use of state courts in North Carolina for debts owed to a retailer who is required to collect use tax for the State on a mail-order transaction but refuses to do so. The provision would apply only to retailers who report gross sales of at least $5 million on the most recent federal income tax return.

(8) Allows the Division of Motor Vehicles to disclose a social security number to the Department of Revenue for the purpose of verifying a taxpayer's identification.

(9) Provides funding for contracts for the collection of delinquent tax debts owed by nonresidents and foreign entities. Funds are provided by allowing the Secretary of Revenue to apply the amounts collected under the contract to the cost of the contract.

(10) Allows the Secretary of Revenue to retain up to $500,000 from the amounts derived during the 2000-01 fiscal year from the collection of delinquent debts owed by nonresidents and foreign entities. The earmarking would pay for the assistance needed in developing a request for proposal for a more automated tax collection system.

ASSUMPTIONS AND METHODOLOGY: The provisions in the proposal represent implementation steps to achieving the objective of a simplified system of collecting sales and use taxes from remote and in-state retailers. Over the long-term a number of other actions will need to take place in North Carolina and other states to simplify the sales and use tax. Some examples include the development of common product definitions, local tax rate uniformity (numerous rates in other states), product return policies under the new system, joint audit procedures, and state/local tax exemption consistency. Thus, the current proposal is just the first step in a lengthy process.

A recent study by the Center for Business and Economic Research at the University of Tennessee estimates that by calendar year 2003 the incremental state and local revenue loss on e-commerce transactions would be $238 million.

LEGISLATIVE PROPOSAL 3:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO CLARIFY THAT A TAXPAYER IS ENTITLED TO A REFUND OF AN OVERPAYMENT OF THE STATE EXCISE TAX ON CONVEYANCES.

SHORT TITLE: Refund Overpayment of Deed Stamp Tax.

BRIEF OVERVIEW: It establishes a procedure through which a taxpayer may request a refund of an overpayment of the State excise tax on conveyances.

FISCAL IMPACT: Minimal impact.

EFFECTIVE DATE: The proposal is effective when it becomes law, and applies retroactively to July 1, 1997.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 3
(00-RBZ-04(4.28))
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Refund Overpayment of Deed Stamp Tax. (Public)

Sponsors: Representatives Pope; Luebke, Allen, Gray, Hill, Jarrell, Miller, Tucker.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THAT A TAXPAYER IS ENTITLED TO A REFUND OF AN OVERPAYMENT OF THE STATE EXCISE TAX ON CONVEYANCES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-228.35 reads as rewritten:

"**§ 105-228.35. Administrative provisions.**

~~The~~ Except as otherwise provided in this Article, the provisions of Article 9 of this Chapter apply to this Article."

Section 2. Article 8E of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-228.37. Refund of overpayment of tax.**

(a) Refund Request. -- A taxpayer who pays more tax than is due under this Article may request a refund of the overpayment by filing a written request for a refund with the board of county commissioners of the county where the tax was paid. The request must be filed within six months after the date the tax was paid and must explain why the taxpayer believes a refund is due.

(b) Hearing by County. -- A board of county commissioners must review a request for refund and must follow the time limitations set in G.S. 105-266.1 for holding a hearing and making a decision. If the board decides that a refund is due, it must refund the overpayment, together with any applicable interest, to

the taxpayer. If the board finds that no refund is due, the written decision of the board must inform the taxpayer that the taxpayer may ask the Secretary to review the decision. The board must send the Secretary a copy of a decision on a request for refund.

(c) Review by Secretary. -- A taxpayer whose request for a refund is denied by a board of county commissioners may obtain a review of the board's decision by the Secretary. The request must be made in writing and must be filed within 30 days after the taxpayer receives the board's decision denying the refund. The Secretary must send the board of county commissioners a copy of the Secretary's decision made on the request. If the Secretary determines that a refund is due, the board of county commissioners must refund the overpayment, together with any applicable interest, to the taxpayer. A decision of the Secretary is binding on a board of county commissioners.

(d) Judicial Review. -- A taxpayer who disagrees with a decision of the Secretary may bring an action against the county and the State to recover the disputed overpayment. The action may be brought in the Superior Court of Wake County or in the superior court of the county where the tax was paid.

(e) Recording Correct Deed. -- Before a tax is refunded, the taxpayer must record a new instrument reflecting the correct amount of tax due. If no tax is due because an instrument was recorded in the wrong county, then the taxpayer must record a document stating that no tax was owed because the instrument being corrected was recorded in the wrong county. The taxpayer must include in the document the names of the grantors and grantees and the deed book and page number of the instrument being corrected.

When a taxpayer records a corrected instrument, the taxpayer must inform the Register of Deeds that the instrument being recorded is a correcting instrument. The taxpayer must give the Register of Deeds a copy of the decision granting the refund that shows the correct amount of tax due. The correcting instrument must include the deed book and page number of the instrument being corrected. The Register of Deeds must notify the county finance officer and the Secretary when the correcting instrument has been recorded.

(f) 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. Interest begins to accrue on an overpayment 90 days after the tax was paid."

Section 3. Notwithstanding G.S. 105-228.37, as enacted by this act, a refund request filed by a taxpayer who paid the tax imposed by Article 8E of Chapter 105 of the General Statutes on or after July 1, 1997, and whose time limit for requesting a refund expires on or before August 1, 2000, is considered timely if the request is filed with the board of county commissioners by October 1, 2000.

Section 4. This act is effective when it becomes law, and applies retroactively to taxes paid on or after July 1, 1997.

LEGISLATIVE PROPOSAL 3:
Refund Overpayment of Deed Stamp Tax

BILL ANALYSIS

Committee:	Revenue Laws	**Introduced by:**	Rep. Pope
Date:	April 27, 2000	**Summary by:**	Cindy Avrette
Version:	00-RBZ-04(4.19)		Committee Counsel

SUMMARY: ***Legislative Proposal 3 establishes a procedure through which a taxpayer may request a refund of an overpayment of the State excise tax on conveyances. The bill is effective when it becomes law, and applies retroactively to July 1, 1997.***

CURRENT LAW: The excise tax on conveyances, known as the deed stamp tax, is a State tax on instruments transferring an interest in real property. The register of deeds of the county in which the property is located collects the tax when the deed transferring the property is recorded. The person presenting the instrument for recording is responsible for indicating on the instrument the amount of tax due. The register of deeds must collect the tax due and mark on the instrument to indicate payment of the tax and the amount paid. The tax rate is $1.00 for each $500.00 (0.2%) of the value of the property conveyed. The county retains one-half of the net proceeds of the tax and remits the remaining one-half to the State. Seventy-five percent (75%) of the funds remitted to the State is dedicated to the Parks and Recreation Trust Fund created in G.S. 113-44.15 and 25% is dedicated to the Natural Heritage Trust Fund created in G.S. 113-77.7. None of the State's share of the deed stamp tax goes to the General Fund.

The current law does not provide a mechanism for a taxpayer to receive a refund of an overpayment of the tax paid. The administrative provisions in Article 9 of Chapter 105 apply to this tax. Under Article 9, a taxpayer must apply to the Secretary of Revenue for a refund of an overpayment of tax. However, the State excise tax is administered at the county level, as opposed to the State level. Therefore, the refund procedure in Article 9 does not work well for the deed stamp tax.

BILL ANALYSIS: This proposal provides that a taxpayer who pays more tax than is due may request a refund of the overpayment by filing a written request for a refund with the board of county commissioners of the county where the tax was paid. The request must be filed within six months after the date the tax was paid and it must explain why the taxpayer believes a refund is due. There will probably be few instances where a refund is requested, since the taxpayer is responsible for indicating the amount of tax due. However, there are instances when an instrument is recorded in the wrong county. In those cases, no tax would be due in the county where the instrument was recorded and the taxpayer should be entitled to a refund of the tax paid.

The board of county commissioners must review a request for a refund. The board must hold a hearing on the request within 90 days after receiving it. The board must make its decision on the request within 90 days after the hearing and it must send a copy of its decision to the Secretary of Revenue. If the board determines that a refund is due, it must refund the overpayment with interest to the taxpayer. If the board determines that a refund is not due, it must inform the taxpayer that the taxpayer may request the Secretary of Revenue to review the decision.

To obtain a review of the decision by the Secretary, the taxpayer must request a hearing in writing. The request must be filed within 30 days after the taxpayer receives the board of county commissioners' decision denying the refund. Like the board, the Secretary must review the request for a refund within 90 days after the Secretary receives the request. The Secretary must send the board a copy of the Secretary's decision. The Secretary's decision is binding on the board. If the Secretary determines that a refund is due, the board must refund the overpayment with interest to the taxpayer.

A taxpayer that disagrees with the Secretary's decision may bring an action against the county and the State to recover the disputed amount. The action may be brought in the Superior Court of Wake County or in the superior court of the county where the tax was paid.

Before the taxpayer may receive a refund, the taxpayer must record a new instrument indicating the correct amount of tax due. If no tax is due because the instrument was recorded in the wrong county, the taxpayer must record an instrument stating that no tax was owed and the reason why. Once the correcting instrument has been recorded, the Register of Deeds must notify the county finance officer and the Secretary of Revenue so that the overpayment may be refunded to the taxpayer. Like other State taxes, the overpayment bears interest at the rate established in G.S. 105-241.1. The interest begins to accrue on the overpayment 90 days after the tax was paid.

FISCAL ANALYSIS MEMORANDUM

DATE: April 28, 2000

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Legislative Proposal 3
Refund Overpayment of Deed Stamp Tax

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
General Fund	**No Impact**				
Parks & Rec. Trust Fund	**No Impact to Less than $2000 per Year**				
Natural Heritage Trust Fund	**No Impact to Less than $1000 per Year**				
Local Government	**Minimal Impact in Selected Counties**				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, Department of Environment and Natural Resources, County Registers of Deeds, and County Boards of Commissioners.

EFFECTIVE DATE: The bill is effective when it becomes law and applies retroactively to July 1, 1997.

BILL SUMMARY: This bill clarifies that a taxpayer can receive a refund of an overpayment of the Deed Stamp Tax. The act lays out the procedures to apply for such a refund, provides for refunds for overpayments dating back to July 1, 1997, and requires that the taxpayer be paid interest if the money is held more than 90 days before a refund is given.

ASSUMPTIONS AND METHODOLOGY: Under current law, a tax is levied when an interest in real property is transferred. The tax rate is $1.00 for every $500.00 of value transferred. The County Register of Deeds collects the tax. The county retains approximately 51% of these funds (50% plus an administrative allowance) and forwards the balance to the state. Seventy-five percent (75%) of the state funds are deposited in the Parks and Recreation Trust

Fund and twenty-five percent (25%) is given to the Natural Heritage Trust Fund. No revenue is retained for the General Fund.

According to the Department of Revenue, Property Tax Division, some counties currently provide refunds when an error is made. Others do not. Taxpayers often file for a refund because either the deed is filed in the wrong county, or a taxpayer paid the tax on a transfer that was not subject to the tax.

The Department reports that in a typical year they see less than $2000 in requests for refunds. They have generally paid the taxpayer if they find that a refund is due. This year, however, one request was filed for a $160,000 refund ($80,000 state, $80,000 local). The state paid its portion of the refund, but the county continues to believe they do not have statutory authority to refund the balance. Some additional refunds may be issued as a result of the retroactive effective date. However, the fiscal impact on local governments is still expected to be very small. The retroactive date should have no fiscal impact on the state funds since the state generally offers the refund.

LEGISLATIVE PROPOSAL 4:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO CLARIFY THE PROPERTY TAX TREATMENT OF A HEALTH CARE FACILITY UNDERTAKEN BY THE MEDICAL CARE COMMISSION PURSUANT TO THE HEALTH CARE FACILITIES FINANCE ACT, AND TO EXTEND THE SUNSET ON THE PROPERTY TAX EXEMPTION FOR CONTINUING CARE RETIREMENT CENTERS.

SHORT TITLE: Health Care Facility and CCRC Tax Exempt.

BRIEF OVERVIEW: Section 1 clarifies that if part but not all of a health care facility is financed by Medical Care Commission bonds or notes, the resulting tax exemption extends only to the part of the facility being financed. Section 2 extends the sunset on the property tax exemption for continuing care retirement centers to July 1, 2001.

FISCAL IMPACT: No General Fund impact, but impacts local revenues.

EFFECTIVE DATE: Section 1 of the proposal becomes effective October 1, 2000, and applies to bonds or notes issued on or after that date. Section 2 of the proposal becomes effective July 1, 2000.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 4
(00-LAX-002(Z))

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Health Care Facility and CCRC Tax Exempt. (Public)

Sponsors: Representatives Jarrell; Luebke, Allen, Gray, Hill, Miller, Pope, Tucker.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THE PROPERTY TAX TREATMENT OF A HEALTH CARE FACILITY UNDERTAKEN BY THE MEDICAL CARE COMMISSION PURSUANT TO THE HEALTH CARE FACILITIES FINANCE ACT, AND TO EXTEND THE SUNSET ON THE PROPERTY TAX EXEMPTION FOR CONTINUING CARE RETIREMENT CENTERS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 131A-21 reads as rewritten:

"**§ 131A-21. Tax exemption.**

The exercise of the powers granted by this Chapter will be in all respects for the benefit of the people of the State and will promote their health and ~~welfare, and no tax or assessment shall be levied upon any health care facilities undertaken by the Commission prior to the retirement or provision for the retirement of all bonds or notes issued and obligations incurred by the Commission in connection with such health care facilities.~~ welfare. If bonds or notes are issued by the Commission to provide or improve a health care facility, then until the bonds or notes are retired the facility for which bonds or notes are issued is exempt from property taxes to the extent provided in this section. An

exemption under this section shall not exceed the lesser of the principal amount of the bonds or notes or the assessed value for ad valorem tax purposes of the facility. In the case of an addition or expansion to a facility, then only the new part is exempt. In the case of renovation to a facility, then only the part being renovated is exempt. In the case of construction of a new facility or improvement to an existing facility that affects the entire facility, then the entire facility is exempt. This section does not affect a health care facility's eligibility for a property tax exemption under Subchapter II of Chapter 105 of the General Statutes.

Any bonds or notes issued by the Commission under the provisions of this Chapter shall at all times be free from taxation by the State or any local unit or political subdivision or other instrumentality of the State, excepting ~~inheritance~~ inheritance, estate, or gift taxes, income taxes on the gain from the transfer of the bonds and notes, and franchise taxes. The interest on the bonds and notes is not subject to taxation as income."

Section 2. Subsection (e) of Section 29A.18 of Chapter 212 of the 1998 Session Laws reads as rewritten:

"(e) Subsection (a) of this section is effective for taxes imposed for taxable years beginning on or after July 1, 1998. Notwithstanding the provisions of G.S. 105-282.1(a), an application for the benefit provided in subsection (a) of this section for the 1998-99 tax year is timely if it is filed on or before November 15, 1998. ~~Subsection (a) of this section~~ G.S. 105-278.6A is repealed effective for taxes imposed for taxable years beginning on or after July 1, ~~2000.~~ 2001. The remainder of this section is effective when it becomes law."

Section 3. Section 1 of this act becomes effective October 1, 2000, and applies to bonds or notes issued on or after that date. Section 2 of this act becomes effective July 1, 2000. The remainder of this act is effective when it becomes law.

LEGISLATIVE PROPOSAL 4:
Health Care Facility and CCRC Tax Exempt

BILL ANALYSIS

Committee:	Revenue Laws Study	Sponsor:	Rep. Mary Jarrell
Date:	May 8, 2000	Analysis by:	Martha K. Walston
Version:	00-LAX-002		Staff Attorney

SUMMARY: Section 1 of the Proposal clarifies that if part but not all of a health care facility is financed by Medical Care Commission bonds or notes, the resulting tax exemption extends only to the part of the facility being financed. Section 1 becomes effective October 1, 2000, and applies to bonds or notes issued on or after that date. Section 2 extends the sunset on the property tax exemption for continuing care retirement centers to July 1, 2001. Section 2 becomes effective July 1, 2000.

SECTION 1 OF PROPOSAL 4

Background. Chapter 131A of the General Statutes sets out the Health Care Facilities Finance Act. This Act was enacted in 1975 to promote the public health and welfare by providing means for financing, refinancing, acquiring, constructing, equipping and providing of health care facilities to serve the people of the State and to make accessible to them modern and efficient health care facilities. The definition of "health care facilities" is set out at the end of the summary for section 1 of this proposal. To carry out its purpose, the Act authorizes the Medical Care Commission to issue bonds or notes for the purpose of providing funds to pay all or any part of the cost of a health care facility. These notes must mature within 10 years from their date or dates, and the bonds must mature at a time not exceeding 40 years from their date or dates. These bonds or notes are not secured by a pledge of the faith and credit of the State or of any political subdivision, do not create an indebtedness of the State or political subdivision, and do not require voter approval. They are payable solely from the revenues and funds provided under the Act.

G.S. 131A-21 of the Act provides that "no tax or assessment shall be levied upon any health care facilities undertaken by the Commission prior to the retirement or provision for the retirement of all bonds or notes issued and obligations incurred by the Commission in connection with such health care facilities." There has been some concern that health care facilities may interpret this language to mean that if the Commission issues bonds or notes to a facility then the facility is entitled to a property tax exemption for the entire facility instead of the part of the facility financed by the bonds or notes.

Bill Analysis. Section 1 of Proposal 4 would clarify the extent of the property tax exemption allowed to health care facilities that have been issued bonds or notes by the Medical Care Commission. The proposal provides that only the part of a facility for which bonds or notes have been issued will be exempt from property taxes. For example, when bonds are used to add to or expand an existing facility then only the new part is exempt from property taxes. If the facility is renovated, then only the part being renovated is exempt. If there is construction of a new facility or an improvement to an existing facility that affects the entire facility then the entire facility is exempt. The statute further clarifies that the property tax exemption allowed the facility cannot exceed the lesser of the principal amount of the bonds or notes or the assessed value of the facility. This language was added to clarify that a facility, whose assessed value

is lower than the amount of the bonds or notes, may not spread the exemption over property owned by the facility that is unrelated to the health care facility.

The proposal does not affect a health care facility's eligibility for a property tax exemption under the property tax statutes in Chapter 105 of the General Statutes. The proposal also does not affect outstanding bonds or notes, since it applies only to bonds or notes issued on or after October 1, 2000.

The Medical Care Commission indicates that over the last 20 years, approximately $5 billion in bonds or notes have been issued. Approximately 90% of these bonds and notes have been issued to hospitals for expansion and renovation of hospital facilities and for purchase of medical equipment. These hospitals have qualified for the property tax exemption under G.S. 105-278.8. This statute exempts the property of hospitals that are organized and operated as a nonprofit and exclusively used for charitable hospital purposes.

Section 1 of the proposal has been reviewed by the Association of County Commissioners, the Institute of Government, the Medical Care Commission, a representative of the North Carolina Association of Non-Profit Homes for the Aging, a representative of the North Carolina Association of Tax Assessors, the Department of Revenue, and the Treasurer's Office.

G.S. 131A-3. Definitions

> (4) "Health care facilities" means any one or more buildings, structures, additions, extensions, improvements or other facilities, whether or not located on the same site or sites, machinery, equipment, furnishings or other real or personal property suitable for health care or medical care; and includes, without limitation: general hospitals, chronic diseases, maternity, mental, tuberculosis and other specialized hospitals; facilities for intensive care and self-care; nursing homes, including skilled nursing facilities and intermediate care facilities; facilities for continuing care of the elderly and infirm; clinics and outpatient facilities; clinical, pathological and other laboratories; health care research facilities; laundries; training facilities for nurses, interns, physicians and other staff members; food preparation and food service facilities; administration buildings, central service and other administrative facilities; communication, computer; and other electronic facilities, fire-fighting facilities, pharmaceutical facilities and recreational facilities; storage space, X-ray, laser, radiotherapy and other apparatus and equipment; dispensaries; utilities; vehicular parking lots and garages; office facilities for health care facilities staff members and physicians; and such other health care facilities customarily under the jurisdiction of or provided by hospitals, or any combination of the foregoing, with all necessary, convenient or related interests in land, machinery, apparatus, appliances, equipment, furnishings, appurtenances, site preparation, landscaping and physical amenities.

SECTION 2 OF PROPOSAL 4

Current Law. G.S. 105-278.6A allows a continuing care retirement center (CCRC) that fails to qualify as charitable to receive a property tax exemption for its property if it meets all of the following requirements:

1. The center owns the property and uses it for a retirement community that includes a skilled nursing facility or an adult care facility and also includes independent living units. Its grounds and buildings must be on a single site and it must be designed for elderly residents.

2. The center must be nonprofit and exempt from income tax, and its assets upon dissolution must revert to a 501(c) (3) charitable organization.
3. The center must have an active fund-raising program to assist it in providing services to those who do not have the financial resources to pay the fees.
4. The governing body of the institution must be selected by a charitable nonprofit organization or fraternal association.
5. All of the center's revenues, less operating and capital expenses, must be applied to providing uncompensated goods and services to the elderly and to the local community, or applied to an endowment or reserve for these purposes.

The property tax exemption for these CCRCs is repealed for taxes imposed for taxable years beginning on or after July 1, 2000.

Bill Analysis. The proposal extends the sunset on the property tax exemption for CCRCs set out in G.S. 105-278.6A from July 1, 2000 to July 1, 2001. This will give interested parties more time to work out a compromise on the tax status of the non-charitable CCRCs.

Background. Prior to 1987, the General Assembly allowed a property tax exemption to homes for the aged, sick, or infirm if exclusively used for a charitable purpose. The owner of the property could not be organized for profit. A charitable purpose is defined as "one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward." The General Assembly also exempted property owned by a charitable association or institution if it was used by the owner or gratuitously made available to a charitable entity and used by that entity.

In 1983 and 1984, the North Carolina courts ruled that two retirement homes, that had sought property tax exemption, were not eligible for the exemption. *Chapel Hill Residential Retirement Center,* 60 N.C. App. 294, rev. denied, 308 N.C. 386 (1983) and *Lutheran Retirement Ministries,* 70 N.C. App. 236, rev. denied, 312 N.C. 622 (1984). In concluding that these homes were not charitable, the courts noted the following facts about one or both institutions:

1. The institution refused to admit applicants with health problems rendering them physically unable to care for themselves.
2. Substantial entrance fees and monthly fees were required from all residents, and applicants had to demonstrate that they were financially capable of supporting themselves for the period of their life expectancy.
3. The operation of the institution was funded entirely or mainly from fees paid by residents, not by donations or endowments.
4. The costs were so high that only a small percentage of the elderly could afford the center.
5. The center retained the right to terminate a resident for nonpayment of fees unless nonpayment was beyond the resident's control.

In response to the courts' rulings, the General Assembly in 1987 enacted G.S. 105-275(32). This legislation classified and excluded from the property tax base certain homes for the "aged, sick, or infirm." To qualify, a continuing care retirement center did not have to be operated as a charity, but it did have to be owned and operated by a nonprofit organization that was a religious or Masonic organization.

G.S. 105-275(32) also required that these homes provide residential and health facilities for the elderly. This legislation promoted residential communities for the elderly that did not qualify for tax exemption under the two prior statutes.

In 1998, Springmoor, Inc., a nonprofit corporation that manages and operates a self-contained residential community for the elderly, successfully challenged the constitutionality of the 1987 legislation. Springmoor alleged that its center met all the requirements of G.S. 105-275(32), except that it was not affiliated with a religious or Masonic organization as required by a subpart of the statute. The North Carolina Supreme Court agreed that the statute violated the First Amendment because it was an unconstitutional establishment of religion. Instead of severing the unconstitutional subpart from the statute, which would have given Springmoor exempt status, the Court ruled the entire statute unconstitutional. The Court explained that it was not the General Assembly's intent to provide a blanket exclusion for all nonprofit homes for the elderly.

After the *Springmoor* decision, the General Assembly enacted G.S. 105-278.6A. This statute temporarily revises the property tax exemption for retirement communities that was held unconstitutional in *Springmoor*. The exemption expires July 1, 2000. The Revenue Laws Study Committee appointed a subcommittee consisting of interested parties (including representatives of the CCRCs, the counties, and the tax assessors) to review the tax status of the CCRCs and to seek a compromise. During its six meetings, the subcommittee discussed numerous proposals and looked at other states' laws. Because the subcommittee did not reach a consensus, it recommended extension of the sunset on the property tax exemption for one year in order to give all interested parties more time to seek a compromise.

FISCAL ANALYSIS MEMORANDUM

DATE: May 4, 2000

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps & Eugene Son
Fiscal Research Division

RE: Legislative Proposal 4
Health Care Facility and CCRC Tax Exempt.

FISCAL IMPACT

Yes ( ) **No ( )** **No Estimate Available (X)**

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
General Fund			**No General Fund Impact**		
Local Government			See Assumptions and Methodology		
EXPENDITURES					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: County and Municipal Governments.

EFFECTIVE DATE: Section 1 becomes effective October 1, 2000, and applies to bonds or notes issued on or after that date. Section 2 becomes effective July 1, 2000. The remainder of the bill is effective when it becomes law.

BILL SUMMARY: Under G.S. 131A-21, any health care facility funded through Medical Care Commission bonds or notes is exempt from property tax for the life of that bond or note. Section 1 of the bill clarifies that the exemption only applies to the portion of the facility funded by the Medical Commission bond or note, or the principal amount of that bond or note, whichever is smaller. Section 2 of the bill extends the sunset on the property tax exemption for Continuing Care Retirement Communities to July 1, 2001.

ASSUMPTIONS AND METHODOLOGY:

Section 1: Since its inception in 1975, the Medical Care Commission (MCC), has issued approximately $5 billion in bonds or notes to fund the creation and expansion of North Carolina health care facilities. According to the MCC staff, approximately 10% of these bonds or notes have been issued to CCRCs.

Until recently these bonds were issued almost exclusively to fund the creation of an entirely new facility. In the last five years the MCC has seen a significant increase in the number of applications for the renovation and expansion of existing facilities. The MCC anticipates this trend to continue and accelerate over time.

According to the Department of Revenue officials and local county assessors, there has been some confusion as to whether the entire facility should be exempt from tax solely because MCC bonds or notes fund a portion of the facility. At this point Fiscal Research is aware of at least two CCRCs that are requesting a property tax exemption for their entire facility based on partial Medical Care Commission bond funding.

Because the bill is prospective, the legislation will not impact facilities funded under existing bonds. MCC staff also believe that this will not impact the state's non-profit hospitals since these hospitals already receive a property tax exemption for most of their holdings under G.S. 105-278.8 (charitable hospital). As a result, most of these hospital facilities are exempt from property tax with or without MCC funding. The primary impact will occur in communities with Continuing Care Retirement Communities that will apply for MCC funding in the future, since many of these facilities are or could be subject to property tax. Since Fiscal Research cannot anticipate the amount of bonds to be issued in the future to these facilities, no fiscal estimate is possible.

Section 2: G.S. 105-278.6A allows a Continuing Care Retirement Center (CCRC) that fails to qualify as charitable to receive a property tax exemption for its property if it meets all of the following requirements:

1. The center owns the property and uses it for a retirement community that includes a skilled nursing facility or an adult care facility, and also includes independent living units. Its ground and buildings must be on a single site and it must be designed for elderly residents.
2. The center must be nonprofit and exempt from income tax, and its assets upon dissolution must revert to a 501 (c) (3) charitable organization.
3. The center must have an active fund raising program to assist it in providing services to those who do not have the financial resources to pay the fees.
4. The governing body of the institution must be selected by a charitable nonprofit organization or fraternal organization.
5. All of the center's revenues, less operating and capital expenses, must be applied to providing uncompensated goods and services to the elderly and to the local community, or applied to an endowment or reserve for that purpose.

The property tax exemption for these CCRCs is repealed for taxes imposed for taxable years beginning on or after July 1, 2000. The proposed bill extends the sunset on the property tax

exemption for CCRCs set out in G.S. 105-278.6A to *July 1, 2001.* This will give interested parties additional time to reach a compromise on the tax status of the non-charitable CCRCs.

Technically, extending the property tax sunset one year has no fiscal impact on local governments. Prior to 1998, the non-charitable CCRCs were exempt from property tax. Since July 1, 1998, non-charitable CCRCs have been exempt from property taxes under G.S. 105-278.6A. Even with the impending sunset in 2000, local governments have not included CCRC revenue in their budget availability for FY 2000-2001. However, if the sunset were to expire in 2000 and the non-charitable CCRCs became fully taxable, then county governments could assess taxes on the property and receive an estimated $2.8 million in property tax revenues. (No figure is available for city property taxes at this time.) There is no general fund impact of the proposal.

LEGISLATIVE PROPOSAL 5:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO MODIFY THE INCOME TAX CREDIT FOR JOB CREATION, TO MAKE A CORRECTION TO THE CREDIT FOR INVESTING IN MACHINERY AND EQUIPMENT, AND TO CLARIFY THAT A TAXPAYER WHO CLAIMS A TAX CREDIT UNDER THE WILLIAM S. LEE ACT LOSES ANY REMAINING INSTALLMENTS IF THE TAXPAYER CEASES TO ENGAGE IN AN ELIGIBLE BUSINESS.

SHORT TITLE: Modify Bill Lee Tax Credits.

BRIEF OVERVIEW: It amends the Bill Lee Act in three ways:

- It modifies the jobs tax credit to allow a taxpayer to claim a tax credit for creating a full-time job when it has 5 full-time employees regardless of how many weeks those employees work during the taxable year.
- It corrects a provision in the tax credit for investing in machinery and equipment that penalizes a taxpayer for replacing recently acquired equipment with new equipment.
- It clarifies that a taxpayer loses any remaining installments on tax credits claimed under the Bill Lee Act if the taxpayer ceases to engage in an eligible business.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: This proposal is effective for taxable years beginning on or after January 1, 2000.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 5
(99-LYX-066C(Z)(3.23))
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Modify Bill Lee Tax Credits. (Public)

Sponsors: Representatives Allen; Gray, Hill, Jarrell, Luebke, Miller, Pope, Tucker.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE INCOME TAX CREDIT FOR JOB CREATION, TO MAKE A CORRECTION TO THE CREDIT FOR INVESTING IN MACHINERY AND EQUIPMENT, AND TO CLARIFY THAT A TAXPAYER WHO CLAIMS A TAX CREDIT UNDER THE WILLIAM S. LEE ACT LOSES ANY REMAINING INSTALLMENTS IF THE TAXPAYER CEASES TO ENGAGE IN AN ELIGIBLE BUSINESS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-129.8(a) reads as rewritten:

"(a) Credit. -- A taxpayer that meets the eligibility requirements set out in G.S. 105-129.4, has five or more ~~employees for at least 40 weeks during the taxable year,~~ full-time employees, and hires an additional full-time employee during that year to fill a position located in this State is allowed a credit for creating a new full-time job. The amount of the credit for each new full-time job created is set out in the table below and is based on the enterprise tier of the area in which the position is located. In addition, if the position is located in a development zone, the amount of the credit is increased by four thousand dollars ($4,000) per job.

Area Enterprise Tier	Amount of Credit
Tier One	$12,500

Tier Two	4,000
Tier Three	3,000
Tier Four	1,000
Tier Five	500

A position is located in an area if more than fifty percent (50%) of the employee's duties are performed in the area. The credit may not be taken in the taxable year in which the additional employee is hired. Instead, the credit shall be taken in equal installments over the four years following the taxable year in which the additional employee was hired and shall be conditioned on the continued employment by the taxpayer of the number of full-time employees the taxpayer had upon hiring the employee that caused the taxpayer to qualify for the credit.

If, in one of the four years in which the installment of a credit accrues, the number of the taxpayer's full-time employees falls below the number of full-time employees the taxpayer had in the year in which the taxpayer qualified for the credit, the credit expires and the taxpayer may not take any remaining installment of the credit. The taxpayer may, however, take the portion of an installment that accrued in a previous year and was carried forward to the extent permitted under G.S. 105-129.5.

Jobs transferred from one area in the State to another area in the State shall not be considered new jobs for purposes of this section. If, in one of the four years in which the installment of a credit accrues, the position filled by the employee is moved to an area in a higher- or lower-numbered enterprise tier, or is moved from a development zone to an area that is not a development zone, the remaining installments of the credit shall be calculated as if the position had been created initially in the area to which it was moved."

Section 2. G.S. 105-129.9 reads as rewritten:

"**§ 105-129.9. Credit for investing in machinery and equipment.**

(a) General Credit. -- If a taxpayer that has purchased or leased eligible machinery and equipment places them in service in this State during the taxable year, the taxpayer is allowed a credit equal to seven percent (7%) of the excess of the eligible investment amount over the applicable threshold. Machinery and equipment are eligible if they are capitalized by the taxpayer for tax purposes under the Code and not leased to another party. In addition, in the case of a large

investment, machinery and equipment that are not capitalized by the taxpayer are eligible if the taxpayer leases them from another party. The credit may not be taken for the taxable year in which the machinery and equipment are placed in service but shall be taken in equal installments over the seven years following the taxable year in which they are placed in service.

(a1) Technology Commercialization Credit. -- If a taxpayer is eligible for the credit allowed in this section with respect to eligible machinery and equipment and qualifies for one of the credits allowed in G.S. 105-129.9A with respect to the same machinery and equipment, the taxpayer may choose to take one of those credits instead of the credit allowed in this section. A taxpayer may take the credit allowed in this section or one of the credits allowed in G.S. 105-129.9A during a taxable year with respect to eligible machinery and equipment, but may not take more than one of these credits with respect to the same machinery and equipment.

(b) Eligible Investment Amount. -- The eligible investment amount is the lesser of (i) the cost of the eligible machinery and equipment and (ii) the amount by which the cost of all of the taxpayer's eligible machinery and equipment that are in service in this State on the last day of the taxable year exceeds the cost of all of the taxpayer's eligible machinery and equipment that were in service in this State on the last day of the base year. The base year is that year, of the three immediately preceding taxable years, in which the taxpayer had the most eligible machinery and equipment in service in this State. A taxpayer that claims a credit under this section must include with the application for certification required under G.S. 105-129.6(a) specific documentation supporting the taxpayer's calculation of the eligible investment amount under this subsection.

(c) Threshold. -- The applicable threshold is the appropriate amount set out in the following table based on the enterprise tier of the area where the eligible machinery and equipment are placed in service during the taxable year. If the taxpayer places eligible machinery and equipment in service in more than one area during the taxable year, the threshold applies separately to the eligible machinery and equipment placed in service in each area. If the taxpayer places eligible machinery and equipment in service in an area over the course of a two-year period, the applicable threshold

for the second taxable year is reduced by the eligible investment amount for the previous taxable year.

Area Enterprise Tier	Threshold
Tier One	$ -0-
Tier Two	100,000
Tier Three	200,000
Tier Four	500,000
Tier Five	1,000,000

(d) Expiration. -- If, in one of the seven years in which the installment of a credit accrues, the machinery and equipment with respect to which the credit was claimed are disposed of, taken out of service, or moved out of State, the credit expires and the taxpayer may not take any remaining installment of the ~~credit.~~ credit for that machinery and equipment unless the cost of that machinery and equipment is offset in the same taxable year by the taxpayer's new investment in eligible machinery and equipment placed in service in the same enterprise tier, as provided in this subsection. If, during the taxable year the taxpayer disposed of the machinery and equipment for which installments remain, there has been a net reduction in the cost of all the taxpayer's eligible machinery and equipment that are in service in the same enterprise tier as the machinery and equipment that were disposed of, and the amount of this reduction is greater than twenty percent (20%) of the cost of the machinery and equipment that were disposed of, then the taxpayer forfeits the remaining installments of the credit for the machinery and equipment that were disposed of. If the amount of the net reduction is equal to twenty percent (20%) or less of the cost of the machinery and equipment that were disposed of, or if there is no net reduction, then the taxpayer does not forfeit the remaining installments of the expired credit. In determining the amount of any net reduction during the taxable year, the cost of machinery and equipment the taxpayer placed in service during the taxable year and for which the taxpayer claims a credit under Article 3B of this Chapter may not be included in the cost of all the taxpayer's eligible and machinery that are in service. If in a single taxable year machinery and equipment with respect to two or more credits in the same tier are disposed of, the net reduction in the cost of all the taxpayer's eligible machinery and equipment that are in service in the same tier is compared to the total cost of all the machinery and equipment for which

credits expired in order to determine whether the remaining installments of the credits are forfeited.

The ~~taxpayer may, however, take~~ expiration of a credit does not prevent the taxpayer from taking the portion of an installment that accrued in a previous year and was carried forward to the extent permitted under G.S. 105-129.5.

If, in one of the seven years in which the installment of a credit accrues, the machinery and equipment with respect to which the credit was claimed are moved to an area in a higher-numbered enterprise tier, or are moved from a development zone to an area that is not a development zone, the remaining installments of the credit are allowed only to the extent they would have been allowed if the machinery and equipment had been placed in service initially in the area to which they were moved.

(e) Planned Expansion. -- A taxpayer that signs a letter of commitment with the Department of Commerce to place specific eligible machinery and equipment in service in an area within two years after the date the letter is signed may, in the year the eligible machinery and equipment are placed in service in that area, calculate the credit for which the taxpayer qualifies based on the area's enterprise tier and development zone designation for the year the letter was signed. All other conditions apply to the credit, but if the area has been redesignated to a higher-numbered enterprise tier or has lost its development zone designation after the year the letter of commitment was signed, the credit is allowed based on the area's enterprise tier and development zone designation for the year the letter was signed. If the taxpayer does not place part or all of the specified eligible machinery and equipment in service within the two-year period, the taxpayer does not qualify for the benefit of this subsection with respect to the machinery and equipment not placed in service within the two-year period. However, if the taxpayer qualifies for a credit in the year the eligible machinery and equipment are placed in service, the taxpayer may take the credit for that year as if no letter of commitment had been signed pursuant to this subsection. "

Section 3. G.S. 105-129.4 is amended by adding a new subsection to read:

"(a2) Expiration. -- If, during the period that installments of a credit under this Article accrue, the taxpayer is no longer engaged in one of the types of business described in subsection (a) of this section, the credit

expires and the taxpayer may not take any remaining installments of the credit. The taxpayer may, however, take the portion of an installment that accrued in a previous year and was carried forward to the extent permitted under G.S. 105-129.5."

Section 4. This act is effective for taxable years beginning on or after January 1, 2000.

LEGISLATIVE PROPOSAL 5
Modify Bill Lee Tax Credits

BILL ANALYSIS

Committee:	Revenue Laws	Sponsor:	Rep. Allen
Date:	May 8, 2000	Analysis by:	Y. Canaan Huie and Martha H. Harris Staff Attorney
Version:	99-LYX-066C		

SUMMARY: Legislative Proposal 5 amends the Bill Lee Act in three ways, effective for taxable years beginning on or after January 1, 2000:

1. *It modifies the jobs tax credit to allow a taxpayer to claim a tax credit for creating a full-time job when it has 5 full-time employees regardless of how many weeks those employees work during the taxable year.*
2. *It corrects a provision in the tax credit for investing in machinery and equipment that penalizes a taxpayer for replacing recently acquired equipment with new equipment.*
3. *It clarifies that a taxpayer loses any remaining installments on tax credits claimed under the Bill Lee Act if the taxpayer ceases to engage in an eligible business.*

ANALYSIS:

Jobs Tax Credit Change. The Department of Commerce asked the Revenue Laws Study Commission to make this change to eliminate a restriction that has the unintended consequence of preventing a taxpayer from taking a tax credit for jobs created under certain circumstances. Under current law, a taxpayer that meets the eligibility requirements of the Bill Lee Act, has five or more employees for at least 40 weeks of the taxable year, and hires an additional full-time employee to fill a full-time position located in this State may claim a tax credit for creating a new full-time position. The size of the tax credit depends on the location of the new full-time position. The credit for any specific full-time position may be claimed only once and must be taken in installments over four years.

The 40-week requirement has the unintended effect of denying this credit to certain taxpayers. Under current law, an employer would not be eligible for this credit if it were to begin operations with more than 5 employees 13 weeks or more into the taxable year. However, a taxpayer may get around this 40-week requirement by signing a letter of commitment with the Department of Commerce to create at least 20 new full-time jobs in a specific area within a two-year period. This credit has the same attributes as the one described above. This credit is available in the taxable year after at least 20 employees are hired.

Section 1 of Legislative Proposal 5 would eliminate the 40-week requirement. The requirement does not serve any apparent purpose. It is believed that the fiscal impact of this change would be minimal since most taxpayers would be able to get around the requirement by signing a letter of commitment. The taxpayers that do not qualify for a letter of commitment and thus would benefit from this change are those who would begin operations with between 5 and 20 employees more than 12 weeks into the taxable year.

For illustration, imagine Company X that meets the general eligibility requirements of the Bill Lee Act, has a taxable year that is the calendar year, begins operations in North Carolina in May, and begins operations by hiring 15 new full-time employees. Under current law, Company X would not be eligible for the jobs creation tax credit because it did not have at least 5 employees for at least 40 weeks in the taxable year. Additionally, since Company X did not sign a letter of commitment with the Department of Commerce to hire at least 20 employees, Company X could not get around the 40-week requirement. Neither would Company X be eligible for the tax credit in the following year, since no new positions were created in that year. Under the proposed legislation, Company X would be eligible for the jobs creation tax credit on 10 of the 15 new full-time positions.

Correct Investment Tax Credit. Section 2 of Legislative Proposal 5 would correct a "reverse loophole" in the Bill Lee Act credit for investing in machinery and equipment. Under current law, if a taxpayer earns a credit for investing in machinery and then, within the seven-year period that installments of the credit are allowed, replaces the machinery with newly acquired machinery, the taxpayer not only loses the remaining installments earned on the original machinery but also gets no credit for investing in the replacement machinery except to the extent its value exceeds the value of the original machinery. Section 2 of this bill corrects this reverse loophole by providing that the remaining installments of the credit for the original machinery may be taken if the value of newly acquired machinery in the same enterprise tier offsets at least 80% of the value of the original machinery taken out of service. As under current law, a new credit is allowed to the extent the remaining value of the newly acquired machinery creates a net investment increase in excess of the applicable investment threshold. As under current law, there is no penalty if the taxpayer replaces the machinery after the end of the seven-year installment period.

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.[1] 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-

[1] If the investment is $150 million or more, the machinery need not be capitalized if it is leased from another party.

Tier Two
100,000
Tier Three
200,000
Tier Four
500,000
Tier Five
1,000,000

The credit is allowed only for net new investment because it is intended to reward activity that provides a net benefit to the State. If a taxpayer replaces existing machinery or closes a plant in one county and opens one in a different county, there is no credit.

The credit must be taken in seven equal installments, beginning the year after the equipment is placed in service. If the equipment is taken out of service within the seven-year period, the taxpayer forfeits any remaining installments. The purpose of this forfeiture provision is to prevent the situation in which a taxpayer invests in equipment, takes the entire credit, and then closes or moves out of State within a few years. The taxpayer must keep the equipment in service in this State for seven years to get the full benefit of the credit.

The effect of these two requirements, (1) net new investment and (2) forfeiture for machinery taken out of service, is that a taxpayer who takes machinery out of service and replaces it with other equipment of similar value could be doubly penalized. If the taxpayer were still taking installments of the credit for investing in the original machinery, those remaining installments would be lost. In addition, because there was no net new investment to the extent the cost of the original machinery was netted against the cost of the replacement machinery, the taxpayer received no credit for investing in the new machinery (except to the extent its cost exceeded the cost of the original machinery).

Under Section 2 of this bill, a taxpayer in this situation would not lose the remaining installments of credit for the original machinery. If the original machinery is taken out of service, but the reduction in the taxpayer's total net investment in the same tier is offset because the taxpayer has invested in new machinery in the same enterprise tier during the same taxable year, the remaining installments may still be taken if the investment in new machinery offsets at least 80% of the cost of the original machinery taken out of service. As under current law, if the taxpayer's entire net investment increases, the taxpayer is also allowed new credit to the extent of the net increase.

Eligible Business Restriction. Section 3 of Legislative Proposal 5 clarifies that if a taxpayer that claims a Bill Lee Act credit ceases to engage in the type of business required to qualify for that credit, the taxpayer loses any remaining installments of the credit (but does not lose accrued carryforwards). The Bill Lee Act was enacted in 1996. It provides tax credits against income tax, franchise tax, and insurance premiums for eligible businesses that are new, or that expand. Only the following businesses are eligible for tax credits under the Bill Lee Act:

1. Air courier services.
2. Central administrative office that creates at least 40 new jobs.
3. Customer service center located in an enterprise tier one or two area
4. Data processing.
5. Electronic mail order house that creates at least 250 new jobs and is located in an enterprise tier one or two area.
6. Manufacturing.
7. Warehousing.
8. Wholesale trade

FISCAL ANALYSIS MEMORANDUM

DATE: April 19, 2000

TO: Revenue Laws Study Committee

FROM: Dave Crotts
Fiscal Research Division

RE: Legislative Proposal 5
Modify Bill Lee Tax Credits (99-LYX-066C)

FISCAL IMPACT

Yes (x) **No ( )** **No Estimate Available ( )**

GENERAL FUND REVENUES: The jobs credit change will lead to an insignificant loss of revenue. There is no data to evaluate the ITC change but the loss should be relatively small.

PRINCIPAL DEPARTMENTS AFFECTED: Department of Commerce and Department of Revenue. The enactment of the bill will not affect the budget requirements of either department.

EFFECTIVE DATE: Tax years beginning on or after January 1, 2000

PROPOSAL SUMMARY: **Jobs Tax Credit Change**. Under the state jobs tax credit, a taxpayer must have 5 or more employees for at least 40 weeks per year to qualify for the credit. The proposal eliminates the 40-week requirement. **Investment Tax Credit Correction**. Under the Bill Lee Act, a targeted investment tax credit for investing in machinery and equipment can be taken over a 7-year period. If the taxpayer replaces the machinery or equipment with newly acquired property during the installment period, the remaining credit installments are eliminated and no credit is allowed on the new items except to the extent that its value exceeds the value of the original machinery. The proposal provides that the remaining installments of the investment tax credit may be taken if the value of the newly acquired machinery and equipment offsets at least 80% of the value of the items taken out of service.

ASSUMPTIONS AND METHODOLOGY: **Jobs Tax Credit Change.** Discussions with the Department of Commerce and Department of Revenue involved with administering the credit indicated that in the past most of the taxpayers affected by the 40-week requirement have been able to qualify through the "letter of commitment" language under G.S. 105-129.8(d). This requirement involves a commitment for "at least twenty new full-time jobs".

LEGISLATIVE PROPOSAL 6:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO PROVIDE FOR WITHHOLDING OF NORTH CAROLINA INCOME TAXES FROM CERTAIN PENSIONS.

SHORT TITLE: Pension Tax Withholding.

BRIEF OVERVIEW: It would require withholding of State income taxes on an eligible rollover distribution and prohibit a taxpayer from an electing out of this withholding on the eligible rollover distribution.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This proposal becomes effective January 1, 2001.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 6
(99-LYXZ-063(3.17))
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Pension Tax Withholding. (Public)

Sponsors: Senators Kerr; Hoyle.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO PROVIDE FOR WITHHOLDING OF NORTH CAROLINA INCOME TAXES FROM CERTAIN PENSIONS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-163.1(11b) reads as rewritten:

"(11b) **(Effective January 1, 2001)** Pension payment. -- A periodic payment or a nonperiodic distribution ~~that is not an eligible rollover distribution,~~ as those terms are defined in section 3405 of the Code."

Section 2. G.S. 105-163.2A(d) reads as rewritten:

"(d) Election of No Withholding. -- The recipient may not elect not to have taxes withheld under this section from an eligible rollover distribution. The recipient may elect not to have taxes withheld under this ~~section.~~ section from a pension payment that is not an eligible rollover distribution. The election must be in the form required by the Secretary. In the case of periodic payments, the election remains in effect until revoked by the recipient. In the case of a nonperiodic distribution, the election applies on a distribution-by-distribution basis unless it meets conditions prescribed by

the Secretary for it to apply to subsequent nonperiodic distributions by the pension payer.

A pension payer must notify each recipient of the right to elect not to have taxes withheld under this section. The notice must comply with the requirements of section 3405 of the Code and any additional requirements prescribed by the Secretary.

A recipient's election not to have taxes withheld under this section is void if the recipient fails to furnish the recipient's tax identification number to the pension payer, or the Secretary has notified the pension payer that the tax identification number furnished by the recipient is incorrect."

Section 3. This act becomes effective January 1, 2001.

LEGISLATIVE PROPOSAL 6: Pension Tax Withholding

BILL ANALYSIS

Committee:	Revenue Laws	Sponsor:	Sen. Dalton
Date:	May 8, 2000	Analysis by:	Y. Canaan Huie
Version:	99-LYXZ-063		Staff Attorney

SUMMARY: This bill would require withholding of State income taxes on an eligible rollover distribution and prohibit a taxpayer from electing out of this withholding on the eligible rollover distribution. This bill would become effective January 1, 2001.

ANALYSIS: Under federal law, withholding is required on pensions, annuities, and certain deferred income, including IRAs. However, unless the payment is an eligible rollover distribution[1], a taxpayer may elect not to have tax withheld on a payment.

In 1999, the General Assembly passed House Bill 1466 (S.L. 1999-414) to piggyback this aspect of federal law as it applies to pension payments other than eligible rollover distributions. S.L. 1999-414 required a pension payer already required to withhold federal income tax on a pension payment to a resident of North Carolina also to withhold State income tax unless that payment is an eligible rollover distribution. As under federal law, a recipient of a pension payment that is not an eligible rollover distribution may elect not to have tax withheld from the pension payment. Unlike federal law, S.L. 1999-414 does not require that tax be withheld from an eligible rollover distribution.

This bill would require that North Carolina tax be withheld on eligible rollover distributions. Additionally, under this bill a taxpayer would not have the option of electing not to have tax withheld on an eligible rollover distribution. The effect of this would be to conform North Carolina law to federal law in this regard.

Pension payers requested this bill. They contend that current computer software will not allow for withholding of State taxes in a manner different from withholding of federal taxes.

[1] For practical purposes, an eligible rollover distribution is a distribution from a pension plan before retirement that is includable in gross income and that is not a payment required under federal law (such as a death benefit). The payment must be eligible for rollover into another 401(k) or IRA. Generally, an eligible rollover distribution occurs when an individual changes jobs.

FISCAL ANALYSIS MEMORANDUM

DATE: April 10, 2000

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal 6
Pension Tax Withholding

FISCAL IMPACT

Yes ( ) **No (X)** **No Estimate Available ( )**

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
GENERAL FUND	see Assumptions and Methodology				
EXPENDITURES					
GENERAL FUND	No Fiscal Impact				

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

EFFECTIVE DATE: This act becomes effective January 1, 2001.

BILL SUMMARY: The bill requires withholding of state income taxes on an eligible rollover distribution and prohibits a taxpayer from electing out of withholding on the distribution. This bill will conform state law to federal law in regards to income tax withholding on distributions from pension plans that are eligible for rollover from one 401(k) or IRA into another.

BACKGROUND: The 1999 General Assembly approved HB 1466 (S.L. 1999-414) to provide that a pension payer required to withhold federal taxes on a pension payment to a North Carolina resident must withhold state taxes on a pension payment, annuity, or deferred compensation unless the recipient elects not to withhold. When analyzing the HB 1466, the Fiscal Research Division of the General Assembly found that the Internal Revenue Service (IRS) did not track the number of taxpayers that had federal income tax withheld from their pension payment, annuity, or deferred compensation. When a company submits withheld income taxes, it does not separately account for current and former employees. Similarly, the North Carolina Department of Revenue has no data on the number of taxpayers that had chosen voluntary withholding of their pension payment, annuity, or deferred compensation.

ASSUMPTIONS AND METHODOLOGY: While no data is available from the IRS or the Department of Revenue on withholding on eligible rollover distributions, the General Fund

should not receive a windfall from this tax amendment. First, these IRA or 401(K) distributions normally occur when individuals change jobs. If the individuals roll their pension distributions into another IRA or 401(K) within 60 days, then their withholding is refunded. Second, those not intending to rollover the funds into a new IRA or 401(K) may have already included the tax into their quarterly estimated payments. The state might gain a small amount of interest on funds that are withheld monthly instead of submitted quarterly in estimated payments. Unfortunately, the extent of this gain cannot be quantified.

LEGISLATIVE PROPOSAL 7:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO PROVIDE FOR TRAINING OF MEMBERS OF THE PROPERTY TAX COMMISSION.

SHORT TITLE: Property Tax Commission Training.

BRIEF OVERVIEW: It allows members of the Property Tax Commission to receive travel, subsistence, and salary while being trained.

FISCAL IMPACT: No General Fund impact because the administrative costs of the Property Tax Commission are deducted from the local sales tax. The expenditures under the proposal are expected to be $3,800 annually.

EFFECTIVE DATE: This proposal becomes effective July 1, 2000.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 7
(99-LC-280(3.28)(Z))
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Property Tax Commission Training. (Public)

Sponsors: Senators Hartsell; Dalton, Hoyle, and Kerr.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO PROVIDE FOR TRAINING OF MEMBERS OF THE PROPERTY TAX COMMISSION.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-288(d) reads as rewritten:

"(d) Expenses. -- The members of the Property Tax Commission shall receive travel and subsistence expenses in accordance with G.S. 138-5 and a salary of two hundred dollars ($200.00) a day when hearing ~~cases.~~ or deciding cases and when attending training or continuing education classes on property taxes or judicial procedure. The Secretary of Revenue shall supply all the clerical and other services required by the Commission. All expenses of the Commission and the Department of Revenue in performing the duties enumerated in this Article shall be paid as provided in G.S. 105-501."

Section 2. This act becomes effective July 1, 2000.

LEGISLATIVE PROPOSAL 7: Property Tax Commission Expenses

BILL ANALYSIS

Committee:	Revenue Laws.	Sponsor:	Sen. Hartsell
Date:	April 27, 2000	Analysis by:	Martha H. Harris
Version:	99-LC-280		Staff Attorney

SUMMARY: Allows members of the Property Tax Commission to receive travel, subsistence, and salary while being trained, effective July 1, 2000.

The Property Tax Commission is the five-member State board of equalization and review that hears and decides taxpayers' administrative appeals from decisions concerning the listing, appraisal, or assessment of property made by county boards of equalization and review and boards of county commissioners. The Property Tax Commission consists of five members, three of whom are appointed by the Governor, one of whom is appointed by the General Assembly upon the recommendation of the Speaker of the House of Representatives, and one of whom is appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate. The members serve staggered, four-year terms.

Under current law, the members of the Property Tax Commission receive travel and subsistence expenses in accordance with G.S. 138-5[1] and a salary of two hundred dollars ($200.00) a day when hearing cases. The Department of Revenue requested this proposal to allow members to receive the same amounts for attending educational classes that would increase their knowledge of ad valorem taxation. It is anticipated that some or all members of the Commission may choose to attend the Institute of Government's course on "Fundamentals of Listing and Assessing" and the International Association of Assessing Officials' course on the "Cost Approach to Value." The bill also clarifies that members of the Commission receive salary and reimbursement while deciding, as well as hearing, cases.

The expenses of the Property Tax Commission do not come from the General Fund but are paid by local governments. The Department of Revenue collects local sales taxes on behalf of local governments and distributes the proceeds quarterly. In making these distributions, the Department is required under G.S. 105-501 to deduct the State's costs relating to local property tax administration, the Property Tax Commission, the Institute of Government's property tax training program, and the Local Government Commission.

[1] G.S. 138-5 provides for subsistence expenses of $81.00 a day in-state and $93.00 a day out-of-state, and for mileage reimbursement or reimbursement for actual airfare.

FISCAL ANALYSIS MEMORANDUM

DATE: April 14, 2000

TO: Revenue Laws Study Committee

FROM: Michele T. Nelson
Fiscal Research Division

RE: Property Tax Commission Training (Legislative Proposal 7)

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

	FY 1998-99	FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03
REVENUES	$3,800*	$3,800*	$3,800*	$3,800*	$3,800*
EXPENDITURES	$3,800	$3,800	$3,800	$3,800	$3,800
POSITIONS:					

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

EFFECTIVE DATE: July 1, 2000

* The Department of Revenue collects local sales tax in behalf of local governments and distributes the proceeds, which include the State's administrative cost for the Property Tax Commission per G.S. 105-501. There is no cost to the General Fund.

BILL SUMMARY: G.S. 105-288(d) is amended to allow the 5 members of the Property Tax Commission to be reimbursed when attending training or continuing education classes on property taxes or judicial procedure.

ASSUMPTIONS AND METHODOLOGY:

In accordance with G.S. 138-5 members of the Property Tax Commission receive an allowance for travel and subsistence expenses and a salary of $200.00 per day when hearing cases. This legislation would 1) extend this allowance to members when attending training seminars that would increase their knowledge of Ad Valorem taxation, and 2) pay members the daily rate plus expenses for accommodations, mileage, meals, etc. At this time, two basic seminars are considered appropriate for commission members to attend: the IOG course on the "Fundamentals of Listing and Assessing" and the IAAO (International Association of Assessing Officials) session on the "Cost Approach to Value". It is anticipated that annually members will attend 7 days of training. The estimate of the maximum cost is approximately $11,375: $325 per day, 7 days of seminars, and 5-commission members attending. Because not all the members are new, nor will they all decide to attend the sessions in the same year, a more realistic figure would be about 1/3 of that amount or about $3,800 annually. Funding to support this additional cost will come from the proceeds of the local sales tax collections, which the Department of Revenue is required to deduct per G.S. 105-501.

TECHNICAL CONSIDERATIONS:

LEGISLATIVE PROPOSAL 8:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES.

SHORT TITLE: Revenue Laws Technical Changes.

BRIEF OVERVIEW: It makes numerous technical and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Except as otherwise provided for specific sections, the proposal is effective when it becomes law.

A copy of the proposed legislation, explanation, and fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 8
(99-LCX-257D(1.1)(Z))
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Revenue Laws Technical Changes. (Public)

Sponsors: Representatives Hill; Allen, Gray, Jarrell, Luebke, Miller, Pope, Tucker.

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. Section 33 of S.L. 1999-360 reads as rewritten:

"Section 33. Affordable Housing Credit. -- Part III of this act is effective for taxable years beginning on or after January 1, ~~2000, and applies~~ 2000. Sections 10 through 15 of Part III apply to buildings to which federal credits are allocated on or after January 1, 2000."

Section 2.(a) Section 10.2(3) of Chapter 13 of the Session Laws of the 1996 Second Extra Session, as amended by Section 1 of S.L. 1999-360, reads as rewritten:

"(3) Quality jobs and business expansion tax credits. -- Sections 3.5, 3.6, and 3.8 through 3.10 of Part III of this act become effective August 1, 1996. G.S. 105-129.11, as enacted by Part III of this act, becomes effective for taxable years beginning on or after January 1, 1997, and applies to training expenditures made on or after July 1, 1997. The remainder of Part III

of this act is effective for taxable years beginning on or after January 1, 1996, and applies to jobs created on or after August 1, 1996, and property placed in service on or after August 1, 1996. Article 3A of Chapter 105 of the General Statutes is repealed ~~effective for applications for credits filed under G.S. 105-129.6 on or after January 1, 2006. G.S. 105-129.16 is repealed effective for business property placed in service on or after January 1, 2002. The remainder of~~ as provided in that Article. Article 3B of Chapter 105 of the General Statutes is repealed ~~effective for buildings to which federal credits are allocated on or after January 1, 2006.~~ as provided in that Article. "

Section 2.(b) Section 4 of S.L. 1997-277, as amended by Section 18.1 of S.L. 1999-360, is recodified as G.S. 105-129.2A(b), (c), and (d).

Section 2.(c) G.S. 105-129.2A, as enacted by this act, reads as rewritten:

"**§ 105-129.2A. Sunset; studies.**

(a) Sunset. -- This Article is repealed effective for applications for credits filed under G.S. 105-129.6 on or after January 1, 2006."

(b) Equity Study. -- The Department of Commerce shall study the effect of the tax incentives provided in ~~the William S. Lee Quality Jobs and Business Expansion Act, codified as Article 3A of Chapter 105 of the General Statutes,~~ this Article on tax equity. This study shall include the following:

(1) Reexamining the formula in G.S. 105-129.3(b) used to define enterprise tiers, to include consideration of alternative measures for more equitable treatment of counties in similar economic circumstances.

(2) Considering whether the assignment of tiers and the applicable thresholds are equitable for smaller counties, for example those under 50,000 in population.

(3) Compiling any available data on whether expanding North Carolina businesses receive fewer benefits than out-of-State businesses that locate to North Carolina.

(c) Impact Study. -- The Department of Commerce shall study the effectiveness of the tax incentives provided in ~~the William S. Lee Quality Jobs and Business Expansion Act, codified as Article 3A of Chapter 105 of the General Statutes.~~ this Article. This study shall include:

(1) Study of the distribution of tax incentives across new and expanding industries.

(2) Examination of data on economic recruitment for the period 1994 through 2000 by county, by industry type, by size of investment, and by number of jobs, and other relevant information to determine the pattern of business locations and expansions before and after the enactment of the William S. Lee Act incentives.

(3) Measuring the direct costs and benefits of the tax incentives.

(4) Compiling available information on the current use of incentives by other states and whether that use is increasing or declining.

(d) Report. -- The Department of Commerce shall report the results of these studies and its recommendations to the 2001 General Assembly by April 1, 2001."

Section 2.(d) Article 3B of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-129.15A. Sunset.**

G.S. 105-129.16 is repealed effective for business property placed in service on or after January 1, 2002. The remainder of this Article is repealed effective January 1, 2006. The repeal of G.S. 105-129.16A applies to renewable energy property placed in service on or after January 1, 2006. The repeal of G.S. 105-129.16B applies to buildings to which federal credits are allocated on or after January 1, 2006."

Section 3.(a) G.S. 105-129.17(b) reads as rewritten:

"(b) Cap. -- ~~A total~~ The credits allowed in this Article may not exceed fifty percent (50%) of the tax against which they are claimed for the taxable year, reduced by the sum of all other credits allowed against that tax, except tax payments made by or on behalf of the taxpayer. This limitation applies to the cumulative amount of credit, including carryforwards, claimed by the taxpayer under this Article against each tax for the taxable year. Any unused portion of the credits may be carried forward for the succeeding five years."

Section 3.(b) G.S. 105-129.18 reads as rewritten:

"**§ 105-129.18. Substantiation.**

To claim a ~~credits~~ credit allowed by this Article, the taxpayer must provide any information required by the Secretary of Revenue. Every taxpayer claiming a credit under this Article must maintain and make available for inspection by the Secretary of Revenue any records the Secretary considers necessary to determine and verify the amount of the credit to which the taxpayer is entitled. The burden of proving eligibility for a credit and the amount of the credit rests upon the taxpayer, and no credit may be allowed to a taxpayer that fails to maintain adequate records or to make them available for inspection."

Section 3.(c) G.S. 105-129.19 reads as rewritten:

"**§ 105-129.19. Reports.**

The Department of Revenue shall report to the Legislative Research Commission and to the Fiscal Research Division of the General Assembly by May 1 of each year the following information for the 12-month period ending the preceding April 1:

(1) The number of taxpayers that claimed the credits allowed in this Article.

(2) The cost of business property and renewable energy property with respect to which ~~business property~~ credits were claimed.

(2a) The location of each qualified North Carolina low-income building with respect to which a low-income housing credit was claimed.

(3) The total cost to the General Fund of the credits claimed."

Section 4. The catchline of G.S. 105-40 reads as rewritten:

"**§ 105-40. Amusements -- Certain exhibitions, performances, and entertainments exempt from ~~license~~ tax.**"

Section 5. Effective July 1, 2000, G.S. 105-88(e) reads as rewritten:

"(e) Counties, cities, and towns may levy a license tax on the business taxed under this ~~section not in excess of~~ section. Except as provided in G.S. 160A-211 and G.S. 153A-152, the tax may not exceed one hundred dollars ($100.00)."

Section 6. G.S. 105-113.82 reads as rewritten:

"**§ 105-113.82. Distribution of part of beer and wine taxes.**

(a) Amount, Method. -- The Secretary shall distribute annually the following percentages of the net amount of excise taxes collected on the sale of malt beverages and wine during

the preceding 12-month period ending March 31, less the amount of the net proceeds credited to the Department of Agriculture and Consumer Services under G.S. 105-113.81A, to the counties and cities in which the retail sale of these beverages is ~~authorized:~~ authorized in the entire county or city:

(1) Of the tax on malt beverages levied under G.S. 105-113.80(a), twenty-three and three-fourths percent (23 3/4%);

(2) Of the tax on unfortified wine levied under G.S. 105-113.80(b), sixty-two percent (62%); and

(3) Of the tax on fortified wine levied under G.S. 105-113.80(b), twenty-two percent (22%).

If malt beverages, unfortified wine, or fortified wine may be licensed to be sold at retail in both a county and a city located in the county, both the county and city shall receive a portion of the amount distributed, that portion to be determined on the basis of population. If one of these beverages may be licensed to be sold at retail in a city located in a county in which the sale of the beverage is otherwise prohibited, only the city shall receive a portion of the amount distributed, that portion to be determined on the basis of population. The amounts distributed under subdivisions (1), (2), and (3) shall be computed separately.

~~(b) Reduction in Amount Distributed. -- Where the sale of malt beverages, unfortified wine, or fortified wine is prohibited in a defined area of a city or county in which the sale of the beverage is authorized, the amount that would otherwise be distributed to the city or county on the basis of population under subsection (a) shall be reduced in the same ratio that the area of the defined area bears to the total area of the city or county, unless the defined area is a city. If the defined area in a county is a city, the reduction in the amount that would otherwise be distributed to the county under subsection (a) shall be based on population instead of area.~~

(c) Exception. -- Notwithstanding subsection (a), in a county in which ABC stores have been established by petition, the revenue shall be distributed as though the entire county had approved the retail sale of a beverage whose retail sale is authorized in part of the county.

(d) Time. -- The revenue shall be distributed to cities and counties within 60 days after March 31 of each year.

(e) Population Estimates. -- To determine the population of a city or county for purposes of the distribution required by

this section, the Secretary shall use the most recent annual estimate of population certified by the State Planning Officer.

(f) City Defined. -- As used in this section, the term "city" means a city as defined in G.S. 153A-1(1) or an urban service district defined by the governing body of a consolidated city-county.

(g) Use of Funds. -- Funds distributed to a county or city under this section may be used for any public purpose.

(h) Disqualification. -- No municipality may receive any funds under this section if it was incorporated with an effective date of on or after January 1, 2000, and is disqualified from receiving funds under G.S. 136-41.2. No municipality may receive any funds under this section, incorporated with an effective date on or after January 1, 2000, unless a majority of the mileage of its streets are open to the public. The previous sentence becomes effective with respect to distribution of funds on or after July 1, 1999."

Section 7. G.S. 105-116(d) reads as rewritten:

"(d) Distribution. -- Part of the taxes imposed by this section on electric power ~~companies, natural gas companies, and regional natural gas districts~~ companies is distributed to cities under G.S. 105-116.1."

Section 8. G.S. 105-119 and G.S. 105-120.1 are repealed.

Section 9. G.S. 105-114 reads as rewritten:

"**§ 105-114. Nature of taxes; definitions.**

(a) Nature of Taxes. -- The taxes levied in this Article upon persons and partnerships are for the privilege of engaging in business or doing the act named.

(a1) Scope. -- The taxes levied in this Article upon corporations are privilege or excise taxes levied upon:

(1) Corporations organized under the laws of this State for the existence of the corporate rights and privileges granted by their charters, and the enjoyment, under the protection of the laws of this State, of the powers, rights, privileges and immunities derived from the State by the form of such existence; and

(2) Corporations not organized under the laws of this State for doing business in this State and for the benefit and protection which these corporations receive from the government and

laws of this State in doing business in this State.

~~If~~

(a2) Condition for Doing Business. -- If the corporation is organized under the laws of this State, the payment of the taxes levied by this Article ~~shall be~~ is a condition precedent to the right to continue in the corporate form of ~~organization; and if~~ If the corporation is not organized under the laws of this State, payment of these taxes ~~shall be~~ is a condition precedent to the right to continue to engage in doing business in this State.

(a3) Tax Year. -- The taxes levied in this Article are for the fiscal year of the State in which the taxes become ~~due;~~ due, except that the taxes levied in G.S. 105-122 are for the income year of the corporation in which the taxes become due.

~~G.S. 105-122~~

(a4) No Double Taxation. -- G.S. 105-122 does not apply to ~~street transportation systems taxed under G.S. 105-120.1 or~~ holding companies taxed under G.S. 105-120.2. G.S. 105-122 applies to a corporation taxed under another section of this Article only to the extent the taxes levied on the corporation in G.S. 105-122 exceed the taxes levied on the corporation in other sections of this Article.

(b) Definitions. -- The following definitions apply in this Article:

(1) City. -- Defined in G.S. 105-228.90.

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

(2) Corporation. -- A domestic corporation, a foreign corporation, an electric membership corporation organized under Chapter 117 of the General Statutes or doing business in this State, or an association that is organized for pecuniary gain, has capital stock represented by shares, whether with or without par value, and has privileges not possessed by individuals or partnerships. The term includes a mutual or capital stock savings and loan association or building and loan association chartered under the laws of any state or of the United States. The term does not include a limited liability company.

(3) Doing business. -- Each and every act, power, or privilege exercised or enjoyed in this State, as

an incident to, or by virtue of the powers and privileges granted by the laws of this State.

(4) Income year. -- Defined in G.S. 105-130.2(5)."

Section 10.(a) G.S. 105-130.15(a) reads as rewritten:

"(a) The net income of a corporation shall be computed in accordance with the method of accounting it regularly ~~employed~~ employs in keeping ~~the books of such corporation, but such method of accounting must~~ its books. The method must be consistent with respect to both income and ~~deductions, but if in any case such~~ deductions. If this method does not clearly reflect the income, the computation shall be made in accordance with ~~such method as in the opinion of the Secretary of Revenue~~ a method that, in the Secretary's opinion, does clearly reflect the income, but shall follow as nearly as practicable the federal practice, unless contrary to the context and intent of this Part.

The Secretary may ~~in his discretion~~ adopt the rules and regulations and any guidelines administered or established by the Internal Revenue Service unless contrary to any provisions of this Part."

Section 10.(b) G.S. 105-130.17(a) reads as rewritten:

"(a) Returns must be filed as prescribed by the Secretary at the place prescribed by the Secretary. Returns must be in the form prescribed by the Secretary. The Secretary shall furnish forms in accordance with G.S. 105-254. ~~shall be in such form as the Secretary of Revenue may from time to time prescribe, and shall be filed with the Secretary at his office, or at any branch office which he may establish. The Secretary shall cause to be prepared blank forms for the said returns, and shall cause them to be distributed throughout the State, and shall furnish them upon request; but failure to receive or secure the form shall not relieve any corporation from the obligation of making any return herein required.~~"

Section 10.(c) G.S. 105-130.18 reads as rewritten:

"**§ 105-130.18. Failure to file returns; supplementary returns.**

If the Secretary ~~of Revenue shall be of the opinion that any~~ determines that a corporation has failed to file a return or to include in a return filed, either intentionally or through error, items of taxable ~~income he may require of such~~ income, the Secretary may require from the corporation a return or supplementary return, under affirmation, ~~in such form as he shall prescribe,~~ of all the items of income ~~which~~ that the corporation received during the year for which the return is

made, whether or not taxable under this Part. If from a supplementary return or otherwise the Secretary finds that any items of income, taxable under this Part, have been omitted from the original return, ~~or~~ that any items returned as taxable ~~that~~ are not taxable, or that any item of taxable income is overstated or understated, ~~he may require any such item to be disclosed to him~~ the Secretary may require that the item be disclosed under affirmation of the corporation, and ~~to~~ be added to or deducted from the original return. ~~Such~~ The filing of a supplementary return and the correction of the original return ~~shall~~ does not relieve the corporation from any of the penalties ~~to which it may be liable under the provisions of~~ under G.S. 105-236. The Secretary may proceed under the provisions of G.S. 105-241.1, whether or not the Secretary ~~he~~ requires a return or a supplementary return under this section."

Section 11. G.S. 105-134.6(b) is amended by adding a new subdivision to read:

"(b) Deductions. -- The following deductions from taxable income shall be made in calculating North Carolina taxable income, to the extent each item is included in taxable income:

. . .

"(5b) The amount received during the taxable year from one or more State, local, or federal government retirement plans to the extent the amount is exempt from tax under this Part pursuant to a court order in settlement of the following cases: Bailey v. State, 92 CVS 10221, 94 CVS 6904, 95 CVS 6625, 95 CVS 8230; Emory v. State, 98 CVS 0738; and Patton v. State, 95 CVS 04346. Amounts deducted under this subdivision may not also be deducted under subdivision (6) of this subsection."

Section 12. G.S. 105-163.44 is repealed.

Section 13. G.S. 105-164.3(8a) reads as rewritten:

"(8a) 'Manufactured home' means a structure that is designed to be used as a dwelling and is manufactured in accordance with the specifications for manufactured homes issued by the United States Department of Housing and Urban Development. ~~and:~~

~~a. Is built on a permanent chassis;~~

~~b. Is transportable in one or more sections;~~

~~c. When transported, is at least eight feet wide or forty feet long; and~~

~~d. When erected on a site, has at least 320 square feet.~~"

Section 14.(a) G.S. 105-164.4(c) reads as rewritten:

"(c) Certificate of Registration. -- Before a person may ~~Before a person may~~ engage in business as a retailer or a wholesale merchant, the person must obtain a certificate of registration from the ~~Department. To obtain a certificate of registration, a person must register with the Department.~~

~~A certificate of registration is valid unless it is revoked for failure to comply with the provisions of this Article or becomes void. A certificate issued to a retailer who makes taxable sales becomes void if, for a period of 18 months, the retailer files no returns or files returns showing no sales.~~ Department in accordance with G.S. 105-164.29."

Section 14.(b) G.S. 105-164.29 reads as rewritten:

"**§ 105-164.29. Application for ~~licenses~~ certificate of registration by wholesale merchants and retailers.**

(a) Application. -- ~~Every application for a license by a wholesale merchant or retailer shall be made upon a form prescribed by the Secretary and shall set forth all information the Secretary may require.~~ To obtain a certificate of registration, a person must register with the Department. A wholesale merchant or retailer who has more than one business is required to obtain only one certificate of registration to cover all operations of the business throughout the State. An application for registration must ~~The application shall~~ be signed as follows:

(1) By the owner, if the owner is an individual.

(2) By a manager, member, or partner, if the owner is an association, a partnership, or a limited liability company.

(3) By an executive officer or some other person specifically authorized by the corporation to sign the application, if the owner is a corporation. If the application is signed by a person authorized to do so by the corporation, written evidence of the person's authority must be attached to the application.

~~A wholesale merchant or retailer whose business extends into more than one county is required to secure only one license to cover all operations of the business throughout the State.~~

(b) Issuance. -- ~~When the required application has been made the Secretary shall issue a license to the applicant. A license~~ A certificate of registration is not assignable and is valid only for the person in whose name it is ~~issued and for the transaction of business at the place designated in the license. The license holder shall display the license conspicuously at all times at the place for which it was issued.~~ issued. A copy of the certificate of registration must be displayed at each place of business.

(c) ~~Reissuance.~~ Term. -- A certificate of registration is valid unless it is revoked for failure to comply with the provisions of this Article or becomes void. A certificate issued to a retailer who makes taxable sales becomes void if, for a period of 18 months, the retailer files no returns or files returns showing no sales. ~~A person whose license has been previously suspended or revoked shall pay the Secretary fifteen dollars ($15.00) for the reissuance of the license. A wholesale merchant whose annual license has been previously suspended or revoked shall pay the Secretary twenty-five dollars ($25.00) for the reissuance of the license for the remainder of the license year.~~

(d) Revocation. -- Whenever a ~~license holder~~ wholesale merchant or retailer fails to comply with this Article or violates G.S. 14-401.18, the Secretary, upon hearing, after giving ~~the license holder~~ 10 days' notice in writing, specifying the time and place of hearing and requiring the ~~license holder~~ wholesale merchant or retailer to show cause why the ~~license~~ certificate of registration should not be revoked, may revoke or suspend the ~~license.~~ certificate of registration. The notice may be served personally or by registered mail directed to the last known address of the ~~license holder.~~ wholesale merchant or retailer. All provisions with respect to review and appeals of the Secretary's decisions as provided by G.S. 105-241.2, 105-241.3, and 105-241.4 apply to this section.

~~Any wholesale merchant or retailer who engages in business as a seller in this State without a license or after the license has been suspended or revoked, and each officer of any corporation that so engages in business shall be guilty of a Class 3 misdemeanor and only subject to a fine of up to five hundred dollars ($500.00) for each offense.~~"

Section 14.(c) G.S. 105-164.38 reads as rewritten:

"**§ 105-164.38. Tax ~~shall be~~ is a lien.**

(a) The tax imposed by this Article ~~shall be~~ is a lien upon all personal property of any person who is required by this Article to obtain a ~~license~~ certificate of registration to engage in business and who stops engaging in the business by transferring the business, transferring the stock of goods of the business, or going out of business. A person who stops engaging in business ~~shall~~ must file the return required by this Article within 30 days after transferring the business, transferring the stock of goods of the business, or going out of business.

(b) Any person to whom the business or the stock of goods was transferred ~~shall~~ must withhold from the consideration paid for the business or stock of goods an amount sufficient to cover the taxes due until the person selling the business or stock of goods produces a statement from the Secretary showing that the taxes have been paid or that no taxes are due. If the person who buys a business or stock of goods fails to withhold an amount sufficient to cover the taxes and the taxes remain unpaid after the 30-day period allowed, the buyer is personally liable for the unpaid taxes to the extent of the greater of the following:

(1) The consideration paid by the buyer for the business or the stock of goods.

(2) The fair market value of the business or the stock of goods.

(c) The period of limitations for assessing liability against the buyer of a business or the stock of goods of a business and for enforcing the lien against the property ~~shall expire~~ expires one year after the end of the period of limitations for assessment against the person who sold the business or the stock of goods. Except as otherwise provided in this section, a person who buys a business or the stock of goods of a business and that person's liability for unpaid taxes are subject to the provisions of G.S. 105-241.1, 105-241.2, 105-241.3, and 105-241.4 and to other remedies for the collection of taxes to the same extent as if the person had incurred the original tax liability."

Section 15.(a) G.S. 105-187.1 is amended by adding a new subdivision to read:

"(3a) Retailer. -- A retailer as defined in G.S. 105-164.3 who is engaged in the business of selling, leasing, or renting motor vehicles."

Section 15.(b) G.S. 105-187.5(a) reads as rewritten:

"(a) Election. -- A retailer ~~who is engaged in the business of leasing or renting motor vehicles~~ may elect not to pay the tax imposed by this Article at the rate set in G.S. 105-187.3 when applying for a certificate of title for a motor vehicle purchased by the retailer for lease or rental. A retailer who makes this election shall pay a tax on the gross receipts of the lease or rental of the vehicle. Like the tax imposed by G.S. 105-187.3, this alternate tax is a tax on the privilege of using the highways of this State. The tax is imposed on a retailer, but is to be added to the lease or rental price of a motor vehicle and thereby be paid by the person who leases or rents the vehicle."

Section 15.(c) G.S. 20-4.01(5) reads as rewritten:

"(5) Dealer. -- Every person engaged in the business of buying, selling, distributing, or exchanging motor vehicles, ~~trailers~~ trailers, or semitrailers in this State, and having an established place of business in this ~~State and being subject to the tax levied by G.S. 105-89.~~ State.

The terms 'motor vehicle dealer,' 'new motor vehicle dealer,' and 'used motor vehicle dealer' ~~shall~~ as used in Article 12 of this Chapter have the meaning set forth in G.S. 20-286."

Section 16. G.S. 105-187.6(b) reads as rewritten:

"(b) Partial Exemptions. -- A maximum tax of forty dollars ($40.00) applies when a certificate of title is issued as the result of a transfer of a motor vehicle:

(1) To a secured party who has a perfected security interest in the motor vehicle.

(2) To a partnership, limited liability company, or corporation as an incident to the formation of the partnership, limited liability company, or corporation, and no gain or loss arises on the transfer of the motor vehicle under section 351 or section 721 of the ~~Internal Revenue Code as defined in G.S. 105-228.90,~~ Code, or to a partnership, limited liability company, or corporation by merger, conversion, or consolidation in accordance with applicable law."

Section 17. G.S. 105-228.90(b) is amended by adding a new subdivision to read:

"(2) Department. -- The Department of Revenue."

Section 18. G.S. 105-236(10) reads as rewritten:

"(10) Failure to File Informational Returns. --

a. Repealed by Session Laws 1998-212, s. 29A.14(m).

b. The Secretary may request a person who fails to file timely statements of payment to another person with respect to wages, dividends, rents, or interest paid to that person to file the statements by a certain date. If the payer fails to file the statements by that date, the amounts claimed on the payer's income tax return as deductions for salaries and wages, or rents or interest shall be disallowed to the extent that the payer failed to comply with the Secretary's request with respect to the statements.

c. For failure to file an informational return required by Article 36C or 36D of this Chapter by the date the return is due, there shall be assessed a penalty of fifty dollars ($50.00)."

Section 19. G.S. 105-259(b)(15) reads as rewritten:

"(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:

. . .

(15) To exchange information concerning a tax imposed by Articles 2A, 2C, or 2D of this Chapter with one of the following agencies when the information is needed to fulfill a duty imposed on the Department or the agency:

a. The North Carolina Alcoholic Beverage Control Commission.

b. The Division of Alcohol Law Enforcement of the Department of Crime Control and Public Safety.

c. The Bureau of Alcohol, Tobacco, and Firearms of the United States Treasury Department.

d. Law enforcement agencies.

e. The Division of Adult Probation and Parole of the Department of Correction."

Section 20. G.S. 105-275(40) reads as rewritten:

"(40) Computer software and any documentation related to the computer software. As used in this subdivision, the term "computer software" means any program or routine used to cause a computer to perform a specific task or set of tasks. The term includes system and application programs and database storage and management programs.

The exclusion established by this subdivision does not apply to computer software and its related documentation if the computer software meets one or more of the following descriptions:

a. It is embedded software. "Embedded software" means computer instructions, known as microcode, that reside permanently in the internal memory of a computer system or other equipment and are not intended to be removed without terminating the operation of the computer system or equipment and removing a computer chip, a circuit, or another mechanical device.

b. It is purchased or licensed from a person who is unrelated to the taxpayer and it is capitalized on the books of the taxpayer in accordance with generally accepted accounting principles, including financial accounting standards issued by the Financial Accounting Standards Board. A person is unrelated to a taxpayer if (i) the taxpayer and the person are not subject to any common ownership, either directly or indirectly, and (ii) neither the taxpayer nor the person has any ownership interest, either directly or indirectly, in the other.

~~This~~

This subdivision does not affect the value or taxable status of any property that is otherwise subject to taxation under this Subchapter.

The provisions of the exclusion established by this subdivision are not severable. If any provision of this subdivision or its application is held invalid, the entire subdivision is repealed."

Section 21. Effective January 1, 2001, G.S. 105-369(b1) reads as rewritten:

"(b1) Notice to Owner. -- After the governing body orders the tax collector to advertise the tax liens, the tax collector must send a notice to the listing owner and to the record owner of each affected parcel of property, as determined as of December 31 of the fiscal year for which the taxes are due. The notice must be sent to each owner's last known address by first-class mail at least 30 days before the date the advertisement is to be published. The notice must state the principal amount of unpaid taxes that are a lien on the parcel to be advertised and inform the owner that the names of the listing owner and the record owner ~~listing owner that his or her name~~ will appear in a newspaper advertisement of delinquent taxes if the taxes are not paid before the publication date. Failure to mail the notice required by this section to the correct listing owner or record owner does not affect the validity of the tax lien or of any foreclosure action."

Section 22. G.S. 105-449.37(a)(1a) reads as rewritten:

(1a) Motor vehicle. -- A motor vehicle as defined in G.S. ~~105-164.3(8c),~~ 105-164.3 other than special mobile equipment as defined in G.S. ~~105-164.3(16b).~~ 105-164.3."

Section 23. G.S. 105-449.44 reads as rewritten:

"**§ 105-449.44. How to determine the amount of fuel used in the State; presumption of amount used.**

(a) Calculation. -- The amount of motor fuel or alternative fuel a motor carrier ~~carries~~ uses in its operations in this State for a reporting period is the ratio of the number of miles the motor carrier travels in this State during that period to the total number of miles the motor carrier travels inside and outside this State during that period, multiplied by the total amount of fuel the motor carrier uses in its operations inside and outside the State during that period.

(b) Presumption. -- The Secretary ~~shall~~ must check reports filed under this Article against the weigh station records and other records of the Division of Motor Vehicles of the

Department of Transportation concerning motor carriers to determine if motor carriers that are operating in this State are filing the reports required by this Article. The Department may assess a motor carrier for the amount payable based on the presumed mileage. A motor carrier that does either of the following for a quarter is presumed to have traveled in this State during that quarter the number of miles equal to 10 trips of 450 miles each for each of the motor carrier's vehicles:

(1) Fails to file a report for the quarter and the records of the Division indicate the carrier operated in this State during the quarter.

(2) Files a report for the quarter that, based on the records of the Division, understates by at least twenty-five percent (25%) the carrier's mileage in this State for the quarter.

(c) Vehicles. -- The number of vehicles of a motor carrier that is registered under this Article is the number of identification markers issued to the carrier. The number of vehicles of a carrier that is not registered under this Article is the number of vehicles registered by the motor carrier in the carrier's base state under the International Registration Plan. ~~The Department shall assess a motor carrier for the amount payable based on the presumed mileage.~~ "

Section 24.(a) Effective July 1, 2000, G.S. 105-449.60(31) and (40) read as rewritten:

"**§ 105-449.60. Definitions.**

The following definitions apply in this Article:

. . .

(31) Supplier. -- Any of the following:

a. A position holder or a person who receives motor fuel pursuant to a two-party ~~transaction.~~ exchange.

b. A fuel alcohol provider.

. . .

(40) Two-party ~~transaction.~~ exchange. -- A transaction in which motor fuel is transferred ~~between two licensed suppliers as the motor fuel crosses the terminal rack as the result of an exchange agreement or a sale between the suppliers that requires the supplier that is the position holder~~ from one licensed supplier to another licensed supplier pursuant to an exchange agreement under which the supplier that

is the position holder agrees to deliver motor fuel to the other supplier or the other supplier's customer at the rack of the terminal at which the delivering supplier is the position holder."

Section 24.(b) Effective July 1, 2000, G.S. 105-449.88 is amended by adding a new subdivision to read:

"**§ 105-449.88. Exemptions from the excise tax.**

The excise tax on motor fuel does not apply to the following:

. . .

(1a) Motor fuel removed by transport truck from a terminal for export if the motor fuel is removed by a licensed distributor or licensed exporter, the supplier that is the position holder for the motor fuel sells the motor fuel to another supplier as the motor fuel crosses the terminal rack, the purchasing supplier or its customer receives the motor fuel at the terminal rack for export, and the supplier that is the position holder collects tax on the motor fuel at the rate of the motor fuel's destination state."

Section 25.(a) G.S. 105-449.60(41) reads as rewritten:

"**§ 105-449.60. Definitions.**

The following definitions apply in this Article:

. . .

(41) User. -- A person who owns or operates a licensed highway vehicle that has a registered gross vehicle weight of at last 10,001 pounds and who ~~and~~ does not maintain storage facilities for motor fuel."

Section 25.(b) G.S. 105-449.68 reads as rewritten:

"**§ 105-449.68. Restrictions on who can get a license as a distributor.**

A bulk-end user of motor fuel may not be licensed as a distributor unless the bulk-end user also acquires motor fuel from a supplier or from another distributor for subsequent sale. This restriction does not apply to a bulk-end user that was licensed as a distributor on January 1, 1996. If a distributor license held by a bulk-end user on January 1, 1996, is subsequently cancelled, the bulk-end user is subject to the restriction set in this section."

Section 25.(c) G.S. 105-449.97(c) reads as rewritten:

"(c) Percentage Discount. -- A supplier that sells motor fuel directly to an unlicensed distributor or to the bulk-end user, the retailer, or the 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."

Section 26. G.S. 105-449.88(1) reads as rewritten:

"**§ 105-449.88. Exemptions from the excise tax.**

The excise tax on motor fuel does not apply to the following:

(1) Motor fuel removed, by transport truck or another means of transfer outside the terminal transfer system, from a terminal for export, if the motor fuel is removed by a licensed distributor or a licensed exporter and the supplier of the motor fuel collects tax on it at the rate of the motor fuel's destination state."

Section 27. The catchline of G.S. 105-449.105 reads as rewritten:

"**§ 105-449.105. Refunds upon application for tax paid on exempt fuel, lost fuel, and fuel unsalable for highway ~~use, and undyed diesel fuel used in boats.~~ use.**"

Section 28. G.S. 105-449.121(b)(2) reads as rewritten:

(b) Inspection. -- The Secretary or a person designated by the Secretary may do any of the following to determine tax liability under this Article:

. . .

(2) Audit a ~~distributor~~ distributor, a retailer, a bulk-end user, or a motor fuel user that is not licensed under this Article."

Section 29. Section 14 of S.L. 1998-22 reads as rewritten:

"Section 14. (a) Notwithstanding G.S. 105-187.44(b), as enacted by this act, the amount distributed to a city under G.S. 105-187.44(b) for taxes collected for each of the quarters in the ~~fiscal year~~ 1999-2000 and 2000-2001 fiscal years may not exceed its benchmark amount until each city receives an amount equal to its benchmark amount. Each quarter, the Secretary of Revenue shall determine a city's benchmark amount and the amount it would receive under G.S. 105-187.44(b) if not for the redistribution required by this section. The Secretary shall identify those cities whose distribution amounts under G.S. 105-187.44(b) are less than

their benchmark amounts and shall determine the total dollar amount of the shortfall. The Secretary shall reduce the amount to be distributed to those cities whose distribution amount under G.S. 105-187.44(b) exceeds their benchmark amount by the total dollar amount of the shortfall determined for that quarter in proportion to each city's excess. However, in no event may a city's distribution amount be reduced below its benchmark amount. The Secretary will redistribute these monies to the cities whose distribution amounts under G.S. 105-187.44(b) are less than their benchmark amounts in proportion to each city's shortfall. In any quarter that a city does not have a prior year's distribution for the corresponding quarter in fiscal year 1998-99, that city is excluded from the redistribution required under this section for that quarter. In that case, the city will receive the amount it is entitled to receive under G.S. 105-187.44(b), as enacted by this act.

For the purposes of this subsection, the term 'benchmark amount' means the amount a city received under G.S. 105-116.1 attributable to piped natural gas for the corresponding quarter during the fiscal year 1998-99.

(b) The Department of Revenue must calculate the amount a city received for taxes collected for each of the ~~first three~~ quarters in fiscal year 1998-99 under G.S. 105-116.1 that was attributable to piped natural gas. The Department must also calculate the amount each city would have received under G.S. 105-187.44(b), as enacted by this act, for taxes collected for each of the ~~first three~~ quarters in fiscal year 1999-2000. The Department shall give this information to the Revenue Laws Study Committee. The Revenue Laws Study Committee shall study the impact of this act on the distribution of part of the proceeds of the excise tax on piped natural gas to the cities and report its findings, and any recommendation, to the ~~2000 Session of the 1999~~ 2001 General Assembly."

Section 30. G.S. 62-302 reads as rewritten:

"**§ 62-302. Regulatory fee.**

(a) Fee Imposed. -- It is the policy of the State of North Carolina to provide fair regulation of public utilities in the interest of the public, as provided in G.S. 62-2. The cost of regulating public utilities is a burden incident to the privilege of operating as a public utility. Therefore, for the purpose of defraying the cost of regulating public utilities, every public utility subject to the jurisdiction of the

Commission shall pay a quarterly regulatory fee, in addition to all other fees and taxes, as provided in this section. The fees collected shall be used only to pay the expenses of the Commission and the Public Staff in regulating public utilities in the interest of the public.

It is also the policy of the State to provide limited oversight of certain electric membership corporations as provided in G.S. 62-53. Therefore, for the purpose of defraying the cost of providing the oversight authorized by G.S. 62-53 and G.S. 117-18.1, each fiscal year each electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale as provided in G.S. 117-16 shall pay an annual fee as provided in this section.

(b) Public Utility Rate. --

~~(1) For the 1989-90 fiscal year, the regulatory fee shall be the greater of (i) twelve hundredths percent (0.12%) of each public utility's North Carolina jurisdictional revenues for each quarter or (ii) six dollars and twenty-five cents ($6.25) each quarter.~~

(2) ~~For fiscal years beginning on or after July 1, 1990, the~~ The public utility regulatory fee for each fiscal year shall be the greater of (i) a percentage rate, established by the General Assembly, of each public utility's North Carolina jurisdictional revenues for each quarter or (ii) six dollars and twenty-five cents ($6.25) each quarter.

When the Commission prepares its budget request for the upcoming fiscal year, the Commission shall propose a percentage rate of the public utility regulatory fee. For fiscal years beginning in an odd-numbered year, that proposed rate shall be included in the budget message the Governor submits to the General Assembly pursuant to G.S. 143-11. For fiscal years beginning in an even-numbered year, that proposed rate shall be included in a special budget message the Governor shall submit to the General Assembly. The General Assembly shall set the percentage rate of the public utility regulatory fee by law.

The percentage rate may not exceed the amount necessary to generate funds sufficient to defray the estimated cost of the operations of the Commission and the Public Staff for the upcoming fiscal year, including a reasonable margin for a reserve fund. The amount of the reserve may not exceed the estimated cost of operating the Commission and the Public Staff for the upcoming fiscal year. In calculating the amount of the reserve, the General Assembly shall consider all relevant factors that may affect the cost of operating the Commission or the Public Staff or a possible unanticipated increase or decrease in North Carolina jurisdictional revenues.

(3) If the Commission, the Public Staff, or both experience a revenue shortfall, the Commission shall implement a temporary public utility regulatory fee surcharge to avert the deficiency that would otherwise occur. In no event may the total percentage rate of the public utility regulatory fee plus any surcharge established by the Commission exceed twenty-five hundredths percent (0.25%).

(4) As used in this section, the term 'North Carolina jurisdictional revenues' means all revenues derived or realized from intrastate tariffs, rates, and charges approved or allowed by the Commission or collected pursuant to Commission order or rule, but not including tap-on fees or any other form of contributions in aid of construction.

(b1) Electric Membership Corporation Rate. -- ~~For the purpose of providing the oversight authorized by G.S. 62-53 and G.S. 117-18.1, beginning with the 1999-2000 fiscal year the North Carolina Electric Membership Corporation shall pay an annual flat fee to the fund established in subsection (d) of this section.~~ The ~~amount of the annual~~ electric membership corporation regulatory fee for each fiscal year shall be a dollar amount as established by the General Assembly by law.

When the Commission prepares its budget request for the upcoming fiscal year, the Commission shall propose the amount of the electric membership corporation regulatory fee. For fiscal years beginning in an odd-numbered year, the proposed

amount shall be included in the budget message the Governor submits to the General Assembly pursuant to G.S. 143-11. For fiscal years beginning in an even-numbered year, the proposed amount shall be included in a special budget message the Governor shall submit to the General Assembly.

The amount of the electric membership corporation regulatory fee proposed by the Commission may not exceed the amount necessary to defray the estimated cost of the operations of the Commission and the Public Staff for the regulation of the electric membership corporations in the upcoming fiscal year, including a reasonable margin for a reserve fund. The amount of the reserve may not exceed the estimated cost of the Commission and the Public Staff for the regulation of the electric membership corporations for the upcoming fiscal year. ~~The fee will be assessed on a quarterly basis and will be due and payable to the Commission on or before the 15th day of the second month following the end of each quarter.~~

(c) When Due. -- The electric membership corporation regulatory fee imposed under this section shall be paid in quarterly installments. The fee is due and payable to the Commission on or before the 15th day of the second month following the end of each quarter.

The public utility regulatory fee imposed under this ~~section, except the fee imposed by subsection (b1) of this section,~~ section is due and payable to the Commission on or before the 15th day of the second month following the end of each quarter. Every public utility subject to the public utility regulatory fee shall, on or before the date the fee is due for each quarter, prepare and render a report on a form prescribed by the Commission. The report shall state the public utility's total North Carolina jurisdictional revenues for the preceding quarter and shall be accompanied by any supporting documentation that the Commission may by rule require. Receipts shall be reported on an accrual basis.

If a public utility's report for the first quarter of any fiscal year shows that application of the percentage rate would yield a quarterly fee of twenty-five dollars ($25.00) or less, the public utility shall pay an estimated fee for the entire fiscal year in the amount of twenty-five dollars ($25.00). If, after payment of the estimated fee, the public utility's subsequent returns show that application of the percentage rate would yield quarterly fees that total more than twenty-five dollars ($25.00) for the entire fiscal year, the public utility shall pay the cumulative amount of the fee

resulting from application of the percentage rate, to the extent it exceeds the amount of fees, other than any surcharge, previously paid.

(d) Use of Proceeds. -- A special fund in the office of State Treasurer, the Utilities Commission and Public Staff Fund, is created. The fees collected pursuant to this section and all other funds received by the Commission or the Public Staff, except for the clear proceeds of civil penalties collected pursuant to G.S. 62-50(d) and the clear proceeds of funds forfeited pursuant to G.S. 62-310(a), shall be deposited in the Utilities Commission and Public Staff 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 shall only be spent pursuant to appropriation by the General Assembly.

The Utilities Commission and Public Staff Fund shall be subject to the provisions of the Executive Budget Act except that no unexpended surplus of the Fund shall revert to the General Fund. All funds credited to the Utilities Commission and Public Staff Fund shall be used only to pay the expenses of the Commission and the Public Staff in regulating public utilities in the interest of the public as provided by this Chapter and in regulating electric membership corporations as provided in G.S. 117-18.1.

The clear proceeds of civil penalties collected pursuant to G.S. 62-50(d) and the clear proceeds of funds forfeited pursuant to G.S. 62-310(a) shall be remitted to the Civil Penalty and Forfeiture Fund in accordance with G.S. 115C-457.2."

Section 31.(a) G.S. 62A-5(d) reads as rewritten:

"(d) Any taxes due on 911 service provided by the service supplier will be billed to the local government subscribing to that service. ~~State and local taxes do not apply to 911 charges billed to subscribers under this Article.~~"

Section 31.(b) G.S. 105-130.5(b)(17) reads as rewritten:

"(17) The amount of 911 charges collected under G.S. 62A-5 and remitted to a local government under G.S. 62A-6, and the amount of wireless Enhanced 911 service charges collected under G.S. 62A-23 and remitted to the Wireless Fund under G.S. 62A-24."

Section 32. Section 3 of S.L. 1999-321 is repealed.

Section 33. G.S. 159-13(b)(6) reads as rewritten:

"(6) The estimated percentage of collection of property taxes shall not be greater than the percentage of the levy actually realized in cash as of June 30 during the preceding fiscal year. For purposes of the calculation under this subdivision only, the levy for the registered motor vehicle tax under Article ~~22C~~ 22A of Chapter 105 of the General Statutes shall be based on the nine-month period ending March 31 of the preceding fiscal year, and the collections realized in cash with respect to this levy shall be based on the twelve-month period ending June 30 of the preceding fiscal year."

Section 34. Except as otherwise provided in this act, this act is effective when it becomes law.

LEGISLATIVE PROPOSAL 8
Revenue Laws Technical Changes

BILL ANALYSIS

Committee:	Revenue Laws	Sponsor:	Rep. Hill
Date:	April 27, 2000	Analysis by:	Martha H. Harris
Version:	Draft LC-257C		Staff Attorney

SUMMARY: This draft bill 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. Except as otherwise provided for specific sections, the bill is effective when it becomes law.

Section	Explanation
1	Corrects effective date for 1999 change to G.S. 105-241.1, the scope of which was inadvertently limited.
2	Reorganizes the sunsets for the William S. Lee Act and the General Business Credits Act, so that the sunset language will be codified within each Act. Also codifies the William S. Lee study provisions with the sunset. Codifying the sunsets separates the two Acts' sunsets, which are currently in the same session law, and makes them easier for taxpayers to find. This section also clarifies the sunset of the Renewable Energy Tax Credits added to the General Business Credits Act in 1999.
3	Corrects wording problems that resulted when two different 1999 acts amended the same statutes.
4	Updates the statute catchline to reflect that the nature of the tax has changed from a license tax to a privilege tax.
5	Clarifies that the $100 local tax limitation enacted in 1999 for loan agencies and other related businesses does not repeal the pre-existing local authority to tax pawnbrokers up to $275 a year. This section becomes effective July 1, 2000.
6	Clarifies that a county or city does not share in the distribution of beer and wine tax if the only place where beer and wine sales are authorized in the county or city is a sports club. Also, repeals an obsolete subsection.
7	Makes conforming change to reflect that natural gas tax is now levied and distributed under a different statute.
8	Repeals the special franchise taxes on telegraph companies and street bus companies. The Department of Revenue states that there are no taxpayers paying tax under these provisions. With repeal of these special taxes, the general corporate franchise tax will apply to any companies that might have otherwise fallen under the provisions of the special taxes.

9 Repeals a cross-reference to the special franchise tax street bus companies, repealed by Section 8, and reorganizes language of statute.

10 Modernizes outdated language in the corporate income tax statutes.

11 Makes a conforming change to recognize that certain State, local, and federal government retirement benefits are exempt from North Carolina income tax pursuant to settlement of the Bailey, Emory, and Patton cases.

12 Repeals a criminal penalty for willful failure to pay corporate estimated tax, because it duplicates a penalty already provided in G.S. 105-236(9), in the general administrative section of the Revenue Act.

13 Changes the form of the definition of manufactured home in the sales tax law from a restatement of federal standards to a cross-reference to federal standards.

14 Conforms the statute to reflect that only one statewide retail sales tax license is required, reorganizes and consolidates two similar statutes, deletes obsolete language regarding renewal fees, and repeals a criminal penalty that duplicates a penalty already provided in the general administrative section of the Revenue Act.

15 Clarifies that a retailer for purposes of Highway Use Tax must be engaged in the business of selling or leasing motor vehicles, and clarifies and updates definition language in Chapter 20 of the General Statutes.

16 Corrects the form of a reference to the Internal Revenue Code

17 Adds a definition of "Department" in Chapter 105 of the General Statutes, consistent with the way the term is used in that Chapter to mean "Department of Revenue."

18 Adds the missing word "the" to the statute.

19 Allows the Department of Revenue to exchange information with the Department of Correction Division of Probation and Parole to assist in collecting the controlled substances tax.

20 Corrects indentation of statute.

21 Makes a conforming change regarding a mailed notice to reflect a 1999 change in the content of tax lien lists published in the newspapers. This section becomes effective January 1, 2001, the same date the 1999 changes become effective.

22 Corrects definitional cross-references to avoid problems when definitions are renumbered.

23 Clarifies that assessments based on presumed mileage are used only if the Department considers the presumption reasonable, corrects incorrect terminology, and changes sentence order.

24 Effective July 1, 2000, changes the method by which tax on fuel is charged at the destination state's rate when the fuel is simultaneously sold from one supplier, to another supplier, to a customer who picks the fuel up at the rack for export. In 1998, S.L. 1998-146 attempted to address this situation by expanding the definition of two-party exchange to include buy-sell

agreements as one type of two-party transaction for purposes of the definition of "supplier". That change created confusion and led to mismatches between terminal operator reports and supplier returns. This section changes back to the old, narrower definition of two-party exchange and then adds a specific provision allowing the destination state's tax rate to be paid when the fuel is transferred at the rack pursuant to a buy-sell agreement.

25 Restores to definition of "user" a provision that was inadvertently deleted, and makes conforming changes to reflect defined term. Users are subject to audit. Adding this vehicle weight threshold, formerly provided in G.S. 105-449.9 (repealed), limits the audit provision to larger vehicles.

26 Conforms exemption statute to reflect that an unlicensed exporter or distributor is liable for tax under G.S. 105-449.82(c). Thus, fuel is exempt only if removed by licensed distributor or licensed exporter.

27 Conforms the statute catchline by removing a reference to a repealed provision.

28 Restores a provision making fuel retailers and bulk-end users subject to audit by the Department of Revenue. S.L. 1999-438 repealed the requirement that retailers and bulk-end users obtain licenses. An unintended consequence of this repeal was elimination of the Department's audit authority over these users and sellers of motor fuel.

29 Extends hold harmless period for piped gas tax distributions to municipalities, to allow the Revenue Laws Study Committee more time to evaluate whether the new distribution method enacted in 1998 will yield distribution amounts that are similar enough to those provided under prior law.

30 Reorganizes and clarifies new regulatory fee levied in 1999 on certain electric membership corporations.

31 Moves tax exemption language from G.S. 62A-5 to the corporate income tax statutes, to make Articles 1 and 2 of Chapter 62A consistent.

32 Section 3 of SL 1999-321 and Section 3 of SL 1999-340 made the same clarifying change to G.S. 96-9(c)(4)b. However, because the language of each section differed slightly, the result was some extra words in the statute. In order to eliminate the extra words, this section repeals Section 3 of S.L. 1999-321. The repeal has no substantive effect because the same change was made by Section 3 of SL 1999-340.

33 Corrects incorrect cross-reference enacted in 1999.

34 Effective date.

FISCAL ANALYSIS MEMORANDUM

DATE: April 12, 2000

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal 8
Revenue Laws Technical Changes

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
LOCAL GOVERNMENTS	See Assumptions and Methodology				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Local governments, Department of Revenue, Department of Correction

EFFECTIVE DATE: The act is effective when it becomes law except for Section 5 (pawnbrokers) and Section 23 (fuel tax) effective July 1, 2000; and Section 20 (tax lien lists) effective January 1, 2001.

BILL SUMMARY: This bill makes numerous technical and clarifying changes to the state revenue laws and related statutes.

ASSUMPTIONS AND METHODOLOGY: Only one of the 33 sections in the bill has a fiscal impact. When the General Assembly approved Senate Bill 1112 (S.L. 1999-438), it inadvertently capped city and county privilege taxes on pawnbrokers at $100. Previous law (G.S. 105-50) allowed cities and counties to charge pawnbrokers up to $275 per year. In a 1996 survey conducted by the Fiscal Research Division of the General Assembly, 44 counties and 24 cities reported having a privilege tax on pawnbrokers ranging from $5 to $275. These local governments also reported FY 1995-96 tax revenues from pawnbrokers of $77,844. If all local governments changed their ordinance in response to SB 1112, then they would have experienced a loss of $47,993 based on the 1996 report. Passage of this bill would allow local governments to return their tax on pawnbrokers to previous levels and regain revenue lost due to SB 1112.

LEGISLATIVE PROPOSAL 9:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO SIMPLIFY THE COLLECTION OF TELECOMMUNICATIONS TAXES.

SHORT TITLE: Simplify Taxes on Telecommunications.

BRIEF OVERVIEW: It makes several changes that would simplify the tax on telecommunications:

- It applies one tax at one rate to all telecommunications services.
- It combines multiple tax rates into one uniform rate equal to 4.5%.
- It broadens the tax base by eliminating exemptions for interstate calls and telephone membership corporations.
- It taxes prepaid telephone calling cards at the point of sale.
- It establishes a local sourcing rule for wireless telecommunications.
- It eliminates complicated distribution formulas for local revenue sharing while preserving the local revenue stream.

FISCAL IMPACT: The proposal establishes a 4.5% tax rate on gross receipts derived from all telecommunications. The new rate replaces the current sales tax and franchise tax on telecommunications. The 4.5% rate was chosen as a revenue neutral rate for the General Fund. Based on fiscal year 1998-99, a revenue neutral tax rate has to generate a minimum of $211.3 million. A 4.5% tax on all telecommunications yields $212.1 million.

EFFECTIVE DATE: The proposal becomes effective January 1, 2001, and applies to taxable services reflected on bills dated on or after January 1, 2001.

A copy of the proposed legislation and explanation begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

S D

LEGISLATIVE PROPOSAL 9
00-RBXZ-03(4.28)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Simplify Taxes on Telecommunications. (Public)

Sponsors: Senators Hoyle; Dalton, Kerr, and Webster.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO SIMPLIFY THE COLLECTION OF TELECOMMUNICATIONS TAXES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.3 is amended by adding the following new subdivisions in the correct alphabetical order to read:

"**§ 105-164.3. Definitions.**

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

...

(11a) Prepaid telephone calling arrangement. -- A right that authorizes the exclusive purchase of telecommunications service; must be paid for in advance; enables the origination of calls by means of an access number, authorization code, or another similar means, regardless of whether the access number or authorization code is manually or electronically dialed; and is sold in units or dollars whose number or

dollar value declines with use and is known on a continuous basis.

...

(16b) Service address. -- The location of the telecommunications equipment from which a customer originates or receives telecommunications service. In the case of wireless telecommunications service, maritime systems, third number calls, calling card calls, and other similar services for which the location of the equipment cannot be determined as part of the billing process, the telecommunications service provider may determine the location of the equipment based upon the customer's telephone number, the mailing address to which the bills are sent, or a street address provided by the customer if the street address is within the licensed service area of the service provider. In the case of telecommunications service paid through a payment mechanism that does not relate to the location of the equipment, such as a bank, travel, debit, or credit card, the service address is the address of the central office as determined by the area code and the first three digits of the seven digit originating telephone number.

...

(21a) Telecommunications service. -- A two-way electronic or electromagnetic transmission that consists of sound, signals, or other intelligence converted to sound or signals and is made by means of wire, cable, radio wave, microwave, light wave, satellite, fiber optics, or another transmission media.

...

(26) Wireless telecommunications service. -- A two-way radio communications service, including cellular telecommunications service, two-way paging service, and any other form of mobile two-way communications service."

Section 2. G.S. 105-164.3(25) is repealed.

Section 3. G.S. 105-164.4(a)(4a) reads as rewritten:

"(4a) The rate of three percent (3%) applies to the gross receipts derived ~~by a utility~~ from sales of ~~electricity or local telecommunications service as defined by G.S. 105-120(e),~~ electricity, other than sales of electricity subject to tax under another subdivision in this section. ~~Gross receipts from sales of local telecommunications service do not include receipts from service provided by means of public coin-operated pay telephone instruments and paid for by coin.~~ A person who ~~operates a utility~~ sells electricity is considered a retailer under this Article."

Section 4. G.S. 105-164.4(a)(4c) reads as rewritten:

"(4c) The rate of ~~six and one-half percent (6 1/2%)~~ four and one-half percent (4.5%) 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.~~ service. A person who provides telecommunications service is considered a retailer under this Article. Telecommunications service is taxed in accordance with G.S. 105-164.4B. ~~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.~~"

Section 5. G.S. 105-164.4(a) is amended by adding a new subdivision to read:

"(4d) The sale or recharge of prepaid telephone calling arrangements is taxable at the rate set in subdivision (a)(1) of this section for sales of tangible personal property. The tax applies regardless of whether tangible personal property, such as a card or a telephone, is transferred. Prepaid telephone calling arrangements taxed under this subsection are not subject to tax as a telecommunications service.

Prepaid telephone calling arrangements are taxable at the point of sale instead of at the point of use. If the sale or recharge of a prepaid telephone calling arrangement does not take place at a retailer's place of business, the sale or recharge is considered to have taken place at one of the following:

a. The customer's shipping address, if an item of tangible personal property is shipped to the customer as part of the transaction.

b. The customer's billing address or, for wireless telecommunications service, the customer's service address, if no tangible personal property is shipped to the customer as part of the transaction."

Section 6. Part 2 of Article 5 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-164.4B. Tax on telecommunications.**

(a) General. -- The gross receipts derived from providing telecommunications service in this State are taxed at the rate set in G.S. 105-164.4(a)(4c). Wireless telecommunications service is provided in this State if the customer's service address is in this State and the call originates or terminates in this State.

(b) Included in Gross Receipts. -- Gross receipts derived from telecommunications service include the following:

(1) Receipts from local, intrastate, interstate, toll, private, and wireless telecommunications service.

(2) Charges for directory assistance, directory listing that is not yellow-page classified listing, call forwarding, call waiting, three-way calling, caller ID, and other similar services.

(3) Customer access line charges billed to subscribers for access to the intrastate or interstate interexchange network.

(4) Charges billed to a pay telephone provider who uses the telecommunications service to provide pay telephone service.

(c) Excluded from Gross Receipts. -- Gross receipts derived from telecommunications service do not include any of the following:

(1) Charges for telecommunications services that are a component part of or are integrated into a telecommunications service that is resold. Examples of services that are resold include carrier charges for access to an intrastate or interstate interexchange network, interconnection charges paid by a provider of wireless telecommunications service, and charges for the sale of unbundled network elements. An unbundled network element is a network element, as defined in 47 U.S.C. § 153(29), to which access is provided on an unbundled basis pursuant to 47 U.S.C. § 251(c)(3).

(2) 911 charges imposed under G.S. 62A-4 or 62A-23 and remitted to the Emergency Telephone System Fund under G.S. 62A-7 or the Wireless Fund under G.S. 62A-24.

(3) Allowable surcharges imposed to recoup assessments for the Universal Service Fund.

(4) Receipts of a pay telephone provider from the sale of pay telephone service.

(5) Charges for commercial, cable, wireless, broadcast, or satellite video or audio service unless the service provides two-way communication, other than the customer's interactive communication in connection with the customer's selection or use of the video or audio service.

(6) Paging service, unless the service provides two-way communication.

(7) Charges for telephone service made by a hotel, motel, or another entity whose gross receipts are taxable under G.S. 105-164.4(a)(3) when the charges are incidental to the occupancy of the entity's accommodations.

(8) Receipts from the sale, installation, maintenance, or repair of tangible personal property.

(9) Directory advertising and yellow-page classified listings.

(10) Voicemail services.

(11) Information services. An information service is a service that can generate, acquire, store, transform, process, retrieve, use, or make available information through a communications service. Examples of an information service include an electronic publishing service and a Web hosting service.

(12) Internet access.

(13) Billing and collection services.

(14) Charges for bad checks or late payments.

(d) Bundled Services. -- When a taxable telecommunications service is bundled with a service that is not taxable, the tax applies to the gross receipts from the taxable service in the bundle as follows:

(1) If the service provider offers all the services in the bundle on an unbundled basis, tax is due on the unbundled price of the taxable service, less the discount resulting from the bundling. The discount for a service as the result of bundling is the proportionate price decrease of the service, determined on the basis of the total unbundled price of all the services in the bundle compared to the bundled price of the services.

(2) If the service provider does not offer one or more of the services in the bundle on an unbundled basis, tax is due on the taxable service based on a reasonable allocation of revenue to that service. If the service provider maintains an account for revenue from a taxable service, the service provider's allocation of revenue to that service for the purpose of determining the tax due on the

service must reflect its accounting allocation of revenue to that service.

(e) Interstate Private Line. -- The gross receipts derived from interstate private telecommunications service are taxable as follows:

(1) One hundred percent (100%) of the charge imposed at each channel termination point in this State.

(2) One hundred percent (100%) of the charge imposed for the total channel mileage between each channel termination point in this State.

(3) Fifty percent (50%) of the charge imposed for the total channel mileage between the first channel termination point in this State and the nearest channel termination point outside this State.

(f) Call Center Cap. -- The gross receipts tax on interstate telecommunications service that originates outside this State, terminates in this State, and is provided to a call center that has a direct pay certificate issued by the Department under G.S. 105-164.27 may not exceed fifty thousand dollars ($50,000) a calendar year. This cap applies separately to each legal entity.

(g) Credit. -- A taxpayer who pays a tax legally imposed by another state on a telecommunications service taxable under this section is allowed a credit against the tax imposed in this section.

(h) Definitions. -- The following definitions apply in this section:

(1) Call center. -- Defined in G.S. 105-164.27.

(2) Interstate telecommunications service. -- Telecommunications service that originates or terminates in this State, but does not both originate and terminate in this State, and is charged to a service address in this State.

(3) Intrastate telecommunications service. -- Telecommunications service that both originates and terminates in this State.

(4) Local telecommunications service. -- Telecommunications service that provides access to a local telephone network and enables a user to communicate with substantially everyone who has a telephone or radiotelephone station that is part of the local telephone network.

(5) Private telecommunications service. -- Telecommunications service that entitles a subscriber of the service to exclusive or priority use of a communications channel or group of channels.
(6) Service address. -- Defined in G.S. 105-164.3.
(7) Telecommunications service. -- Defined in G.S. 105-164.3.
(8) Toll telecommunications service. -- Any of the following:
a. A service for which there is a toll charge that varies in amount with the distance or elapsed transmission time of each individual communication.
b. A service that entitles the subscriber, upon payment of a periodic charge, determined as a flat amount or on the basis of total elapsed transmission time, to an unlimited number of communications to or from all or a substantial portion of those who have a telephone or radiotelephone station in an area outside the local telephone network.
(9) Wireless telecommunications service. -- Defined in G.S. 105-164.3."

Section 7. G.S. 105-164.16(c) reads as rewritten:

"(c) Sales Tax on ~~Utility Services.~~ Electricity and Telecommunications. -- A return for taxes levied under G.S. 105-164.4(a)(4a) and G.S. 105-164.4(a)(4c) is due ~~quarterly or monthly as specified in this subsection. A utility that is allowed to pay tax under G.S. 105-120 on a quarterly basis shall file a quarterly return. All other utilities shall file a monthly return. A quarterly return is due by the last day of the month following the quarter covered by the return. A~~ monthly. The monthly return is due by the last day of the month following the month in which the taxes accrue, except the return for taxes that accrue in May. A return for taxes that accrue in May is due by June 25.

A ~~utility~~ retailer that is required to file a monthly return may file an estimated return for the first month, the second month, or both the first and second months in a quarter. A ~~utility~~ retailer is not subject to interest on or penalties for an underpayment submitted with an estimated monthly return if the ~~utility~~ retailer timely pays at least ninety-five

percent (95%) of the amount due with a monthly return and includes the underpayment with the ~~company's~~ retailer's return for the third month in the same quarter."

Section 8. G.S. 105-164.20 reads as rewritten:

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

Any retailer, except a ~~utility,~~ retailer who sells electricity or telecommunications service, may report sales on either the cash or accrual basis of accounting upon making application to the Secretary for permission to use the basis 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~~ retailer who sells electricity or telecommunications service must report its sales on an accrual basis. A sale ~~by a utility~~ of electricity or ~~intrastate telephone~~ telecommunications service is considered to accrue when the utility bills its customer for the sale."

Section 9. Part 4 of Article 5 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-164.27. Direct pay certificate for call center.**

(a) Requirements. -- A call center that purchases interstate telecommunications service that originates outside this State and terminates in this State may apply to the Secretary for a direct pay certificate. An application for a direct pay certificate must be made on a form provided by the Secretary and contain the information required by the Secretary.

(b) Effect. -- A direct pay certificate authorizes its holder to purchase telecommunications service without paying tax to the seller and authorizes the seller to not collect any tax on a sale to the certificate holder. A person who purchases telecommunications service under a direct pay certificate must file a return and pay the tax due monthly to the Secretary. A direct pay certificate issued under this section does not apply to any tax other than the tax on telecommunications service.

(c) Call Center Defined. -- A call center is a business that is primarily engaged in providing support services to customers by telephone to support products or services of the business. A business is primarily engaged in providing support services by telephone if at least sixty percent (60%) of its calls are incoming."

Section 10. Part 8 of Article 5 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-164.44F. Distribution of part of telecommunications taxes to cities.**

Within 75 days after the end of each calendar quarter, the Secretary must distribute to the cities twelve percent (12%) of the net proceeds of the taxes imposed by G.S. 105-164.4(a)(4c) on telecommunications service. The Secretary must distribute this amount among the cities on a per capita basis according to the most recent annual population estimates certified to the Secretary by the State Planning Officer. A city incorporated on or after January 1, 2000, may not receive a distribution under this section unless it meets both of the following requirements:

(1) It must be eligible to receive funds under G.S. 136-41.2.

(2) A majority of the mileage of its streets must be open to the public."

Section 11. G.S. 105-116(d) reads as rewritten:

"(d) Distribution. -- ~~Part of the taxes imposed by this section on electric power companies, natural gas companies, and regional natural gas districts is distributed to cities under G.S. 105-116.1.~~ Within 75 days after the end of each calendar quarter, the Secretary must distribute to the cities part of the tax proceeds from the gross receipts of an electric power company derived within the city. The amount to be distributed to a city is three and nine hundredths percent (3.09%) of the gross receipts derived within the city."

Section 12. G.S. 105-116.1 is repealed.

Section 13. G.S. 105-120 is repealed.

Section 14. G.S. 105-467 is amended by adding a new subdivision to read:

"(6) The sales price of prepaid telephone calling arrangements taxed as tangible personal property under G.S. 105-164.4(a)(4d)."

Section 15. The first paragraph of Section 4 of Chapter 1096 of the 1967 Session Laws, as amended, is amended as follows:

(1) By deleting the word "and" before subdivision (5).

(2) By changing the period at the end of subdivision (5) to a semicolon and adding the word "and".

(3) By adding a new subdivision to read:

"(6) the sales price of prepaid telephone calling arrangements taxed as tangible personal property under G.S. 105-164.4(a)(4d)."

Section 16.(a) Hold-Harmless. -- For distributions made in calendar quarters beginning on or after April 1, 2001, the combined amount distributed to a city under G.S. 105-116, 105-164.44F, and 105-187.44 is subject to the following conditions:

(1) The amount distributed to a city may not exceed the city's overall benchmark amount until each city receives an amount equal to its overall benchmark amount.

(2) The amount distributed to a city may not be less than the city's overall benchmark amount.

Section 16.(b) Calculation. -- Each quarter, the Secretary of Revenue must determine a city's overall benchmark amount and the amount it would receive under G.S. 105-116, 105-164.44F, and 105-187.44, as modified by S.L. 1998-22, section 14, if not for the redistribution required by this section. The Secretary must identify those cities whose distribution amounts under these three statutes are less than their overall benchmark amounts and must determine the total dollar amount of the shortfall. The Secretary must reduce the amount to be distributed to those cities whose distribution amount under those statutes exceeds their overall benchmark amount by the total dollar amount of the shortfall determined for that quarter in proportion to each city's excess. However, in no event may a city's distribution amount be reduced below its overall benchmark amount. The Secretary must redistribute these monies to the cities whose distribution amounts under the three statutes are less than their overall benchmark amounts in proportion to each city's shortfall. In any quarter that a city does not have a prior year's distribution for the corresponding quarter in the preceding fiscal year, that city is excluded from the redistribution required under this section for that quarter. In that case, the city will receive the amount it is entitled to receive under G.S. 105-116, 105-164.44F, and 105-187.44.

Section 16.(c) Definition. -- As used in this section, the term "overall benchmark amount" means the sum of the following two amounts:

(1) The amount distributed to the city under repealed G.S. 105-116.1 in the same calendar

quarter of the last year in which the city received the distribution under that statute.

(2) The city's piped natural gas benchmark amount for that same quarter, as determined under S.L. 1998-22, section 14.

Section 16.(d) Report. -- The Department of Revenue must report to the Revenue Laws Study Committee by October 1, 2002, on the effect of the changes made by this act on the amounts distributed to cities. The Department must include in its report any adjustments to city distributions recommended by the Department. The Department must consult with the North Carolina League of Municipalities in developing its recommendations.

Section 17. G.S. 153A-152 reads as rewritten:

"**§ 153A-152. Privilege license taxes.**

(a) Authority. -- A county may levy privilege license taxes on trades, occupations, professions, businesses, and franchises to the extent authorized by Article 2 of Chapter 105 of the General Statutes and any other acts of the General Assembly. A county may levy privilege license taxes to the extent formerly authorized by the following sections of Article 2 of Chapter 105 of the General Statutes before they were repealed:

G.S. 105-50	Pawnbrokers.
G.S. 105-53	Peddlers, itinerant merchants, and specialty market operators.
G.S. 105-55	Installing elevators and automatic sprinkler systems.
G.S. 105-58	Fortune tellers, palmists, etc.
G.S. 105-65	Music machines.
G.S. 105-66.1	Electronic video games.
G.S. 105-80	Firearms dealers and dealers in other weapons.
G.S. 105-89	Automobiles, wholesale supply dealers and service stations.
G.S. 105-89.1	Motorcycle dealers.
G.S. 105-90	Emigrant and employment agents.
G.S. 105-102.5	General business license.

(b) Telecommunications Restriction. -- A county may not impose a license, franchise, or privilege tax on a company taxed under G.S. 105-164.4(a)(4c)."

Section 18. G.S. 160A-211 is amended by adding a new subsection to read:

"(d) Telecommunications Restriction. -- A city may not impose a license, franchise, or privilege tax on a company taxed under G.S 105-164.4(a)(4c)."

Section 19. Pursuant to G.S. 62-31 and G.S. 62-32, the Utilities Commission must lower the rate set for local telecommunications service to reflect the repeal of G.S. 105-120.

Section 20. This act becomes effective January 1, 2001, and applies to taxable services reflected on bills dated on or after January 1, 2001. Section 16 expires on July 1, 2003.

LEGISLATIVE PROPOSAL 9:
Simplify the Tax on Telecommunications

BILL ANALYSIS

Committee:	Revenue Laws	**Introduced by:**	Sen. Hoyle
Date:	April 28, 2000	**Summary by:**	Cindy Avrette
Version:	00-RBXZ-03(4.28)		Committee Counsel

SUMMARY: Legislative Proposal 9 makes several changes that will simplify the tax on telecommunications. It taxes prepaid telephone calling cards at the point of sale, it applies one tax at one rate to all telecommunications services, including interstate telecommunications, it establishes a sourcing rule for wireless telecommunications, and it eliminates complicated distribution formulas for local revenue sharing while preserving the local revenue stream.

Background: The General Assembly has not revised the tax structure for telecommunications since 1987. Since that time there have been many changes within the industry that were not contemplated by the tax law. Two of the primary changes that make the current tax law difficult to apply to current industry practices are the advent of cellular phones and prepaid calling cards. The industry continues to change at a rapid pace not foreseen by the 1987 tax law changes.

Two taxes currently apply to telecommunications services. The applicability of the tax varies depending upon the identity of the provider and the type of service. One of these taxes is a gross receipts tax equal to 3.22% of the gross receipts derived by the provider for the provision of local telecommunications services. The second tax is a sales tax. The rate of sales tax varies. The rate is 3.22% for local telecommunications and 6.5% on toll telecommunications services or private telecommunications services that both originate from and terminate in the State, basically intrastate long-distance calls. By definition, the tax does not apply to interstate long-distance calls. Telephone membership corporations have been exempt from the sales tax on telecommunications for many years and coin-operated pay telephone calls, where the call is paid for by a coin, were exempted from the sales tax in 1998.

Under the current distribution of the tax revenue, a city receives 3.09% of the franchise gross receipts tax that is collected from sales within the city, subject to a freeze deduction and a hold-harmless provision. Cities do not receive a percentage of the sales tax revenues. This distribution has become increasingly complicated to administer. The advent of cellular phones has made the task of deciding whether a call is attributable to a particular city very difficult.

Prepaid calling cards have become increasing popular and easy to use. They can be purchased at convenient stores, Walmart, and many other places. However, they are not tangible personal property that is subject to State and local sales tax like most items sold in the stores where they are most often purchased. As a telecommunications service, the tax is imposed on the "air time" and the tax rate differs depending on the type of call. To correctly levy the tax, telephone

companies must track the minutes used by the person who has the prepaid calling card and the type of call placed by the cardholder.

Bill Analysis: This proposal addresses some of the difficulties in our current tax structure:

- It taxes prepaid telephone calling arrangements at the point of sale.
- It applies one tax at one rate to telecommunications service.
- It taxes all telecommunications services equally.
- It establishes a sourcing rule for wireless telecommunications.
- It preserves the local revenue stream, but it eliminates the complicated distribution formulas for local revenue sharing that requires a lot of resources to be spent on determining how to make the distribution.

Sections 1 and 6 of the proposal add definitions for use in taxing telecommunications. The definition for "Prepaid telephone calling arrangement" is consistent with the definition used in other states. Many of the definitions are similar to the ones currently used in G.S. 105-120. The proposal defines some new terms: "service address", "wireless telecommunications service", and "interstate telecommunications service".

Section 2 repeals the definition of "utility" from the sales tax statutes because it is no longer needed. With the separate taxation of telecommunications and piped natural gas, the only industry remaining in the definition of "utility" is electricity. The proposal rewrites the sales tax statutes pertaining to electricity so that the term is not needed. (Sections 3, 7, and 8)

Section 4 sets a uniform tax rate of 4.5% for all telecommunications services, except prepaid telephone calling arrangements. The new rate replaces the current tax structure for telecommunications. The 4.5% rate was chosen as a revenue neutral rate for the General Fund. Based on fiscal year 1998-99, a revenue neutral tax rate has to generate a minimum of $211.3 million. The tax base for the new rate is computed from the franchise tax collections, the 6.5% sales tax collections, and interstate estimates. Using data from New York, the Fiscal Research Division of the General Assembly estimates that interstate calls produce $1.39 billion in receipts. These receipts combined with $3.32 billion in receipts from franchise and sales taxes equals a total revenue base of $4.71 billion. A 4.5% tax on this base yields $212.1 million.

Section 5 taxes prepaid telephone-calling arrangement at the point of sale and identifies the point of sale. Consequently, it sets the tax rate for prepaid telephone calling arrangements at the general State rate of 4% plus the applicable local rates, which are 2% in every county except Mecklenburg, which is 2 ½ %.

Section 6 is the heart of the proposal. It sets forth the taxation of telecommunications:

- It adopts a sourcing rule for wireless telecommunications service that is in the proposed federal Mobile Telecommunications Act. Wireless telecommunications service is provided in this State if the customer's service address is in this State. A service address for wireless telecommunications service may be determined by the provider based upon the customer's telephone number, the mailing address to which the bills are sent, or a street address provided by the customer.

- It addresses the taxation of telecommunications service that is bundled with a service that is not taxable. In those cases, the gross receipts from the total charges are taxable unless the charges are separately stated.
- It taxes all telecommunications service, including interstate telecommunications service and service provided through a telephone membership corporation.
- It replaces the current 3.22% franchise tax on local telecommunications and the 3% and 6.5% sales tax on local telecommunications with a 4.5% gross receipts sales tax on telecommunications.
- It retains the current tax exemption for telecommunications service provided by means of public coin-operated pay telephones and paid for by coin. However, it does include in the definition of gross receipts the access charges billed to a person who uses the access to provide service at a public pay telephone.
- It taxes interstate private lines as follows:
  - 100% of the charge imposed at each channel termination point in this State.
  - 100% of the charge imposed for the total channel mileage between each channel termination point in this State.
  - 50% of the charge imposed for the total channel mileage between the first channel termination point in this State and the nearest channel termination point outside this State.
- It caps the tax on call centers at $50,000 a year. The cap applies to a person who purchases interstate telecommunications service that originates outside the State and terminates in this State and who has a direct pay certificate issued by the Secretary of Revenue. A direct pay certificate authorizes the holder to purchase telecommunications service without paying tax to the seller and authorizes the seller to not collect any tax on a sale to a certificate holder. The certificate holder pays the tax directly to the Department. (Section 9)

Section 10 establishes a new distribution formula that replaces the 3.09% distribution from telephone and electricity gross receipts under G.S. 105-116.1 with a 12% distribution from the telephone gross receipts tax established under this proposal. The distribution proposed in this bill is made on the basis of a city's population. The distribution is intended to correlate directly with gross receipts. The distribution formula proposed in the bill eliminates the need for telephone companies to separately track and report local versus other calling services and eliminates the need to determine where wireless falls in the local/nonlocal mix of calls.

Section 11 makes a conforming change to the distribution of gross receipts franchise taxes on electric power companies. It places the distribution formula in the statute. The distribution is currently in G.S. 105-116.1, but this proposal repeals that statute.

Section 12 repeals the current franchise tax city distribution. The repeal removes the freeze deduction and holdback calculations, which are so difficult to administer. The holdback is subsumed in the new calculation for distribution of the telecommunications taxes. The distribution of electric franchise gross receipts taxes is put in G.S. 105-116.

Section 13 repeals the 3.22% gross receipts franchise tax on telephone companies. The tax is repealed because it is merged into the uniform tax on telecommunications services established in this proposal.

Sections 14 and 15 make conforming changes to the local sales tax statutes. It puts the prepaid telephone calling arrangements in the local sales tax base.

Section 16 protects local revenues from drops resulting from unanticipated shifts in the amounts distributed. This shifting can occur as a result of the changes in the taxation of telecommunications and the new distribution formula for these taxes. It envision that the Department will report the effect of the changes and that any needed adjustments can then be made before July 1, 2003. A similar provision was included in the law that provided a simple, uniform tax structure for piped natural gas.

Sections 17 and 18 preserve the prohibition on county and city taxes on telecommunications services that is now contained in G.S. 105-120(d).

Section 19 requires the Utilities Commission to reduce the rate set for local telecommunications service to reflect the repeal of G.S. 105-120. The North Carolina Supreme Court upheld the Utilities Commission's authority to reduce rates under its rulemaking procedure to reflect a tax reduction that affects an industry uniformly in *State ExRel. Utility Commission v. Nantahala Power & Light Company*, 236 N.C. 190 (1990).

Section 20 provides that this proposal becomes effective January 1, 2001.

LEGISLATIVE PROPOSAL 10:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO CLARIFY THAT THE EXCISE TAX ON CONVEYANCES APPLIES TO TIMBER DEEDS AND CONTRACTS FOR THE SALE OF STANDING TIMBER.

SHORT TITLE: Excise Tax on Timber Contracts.

BRIEF OVERVIEW: It clarifies that the excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This proposal becomes effective July 1, 2000, and applies to timber deeds and contracts for the sale of standing timber executed on or after that date.

A copy of the proposed legislation, explanation, a d fiscal note begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 10
00-LAXZ-004
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Excise Tax on Timber Contracts. (Public)

Sponsors: Representatives Pope; Luebke, Allen, Gray, Hill, Jarrell, Miller, and Tucker.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THAT THE EXCISE TAX ON CONVEYANCES APPLIES TO TIMBER DEEDS AND CONTRACTS FOR THE SALE OF STANDING TIMBER.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-228.30 reads as rewritten:

"**§ 105-228.30. (Effective July 1, 2000) Imposition of excise tax; distribution of proceeds.**

(a) An excise tax is levied on each instrument by which any interest in real property is conveyed to another person. The tax rate is one dollar ($1.00) on each five hundred dollars ($500.00) or fractional part thereof of the consideration or value of the interest conveyed. The transferor must pay the tax to the register of deeds of the county in which the real estate is located before recording the instrument of conveyance. If the instrument transfers a parcel of real estate lying in two or more counties, however, the tax must be paid to the register of deeds of the county in which the greater part of the real estate with respect to value lies.

The excise tax on instruments imposed by this Article applies to timber deeds and contracts for the sale of standing timber to the same extent as if these deeds and contracts conveyed an interest in real property.

(b) The register of deeds of each county must remit the proceeds of the tax levied by this section to the county finance officer. The finance officer of each county must credit one-half of the proceeds to the county's general fund and remit the remaining one-half of the proceeds, less the county's allowance for administrative expenses, to the Department of Revenue on a quarterly basis. A county may retain two percent (2%) of the amount of tax proceeds allocated for remittance to the Department of Revenue as compensation for the county's cost in collecting and remitting the State's share of the tax. Of the funds remitted to it pursuant to this section, the Department of Revenue must credit seventy-five percent (75%) to the Parks and Recreation Trust Fund established under G.S. 113-44.15 and twenty-five percent (25%) to the Natural Heritage Trust Fund established under G.S. 113-77.7."

Section 2. This act becomes effective July 1, 2000, and applies to timber deeds and contracts for the sale of standing timber executed on or after that date.

LEGISLATIVE PROPOSAL 10:
Excise Tax on Timber Contracts

BILL ANALYSIS

Committee: Revenue Laws
Date: April 28, 2000
Version: 00-LAX-004

Introduced by: Representative Pope
Summary by: Martha K. Walston
Committee Counsel

SUMMARY: Legislative Proposal 10 clarifies that the excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber, effective July 1, 2000.

CURRENT LAW: Article 8E of Chapter 105 of the General Statutes contains the provisions for imposing an excise tax on transfers of interests in real estate located in North Carolina. The excise tax is imposed at the rate of $1.00 on each $500.00 or fractional part of the consideration or value of the interest or property conveyed.

The Uniform Commercial Code (UCC) was adopted in Chapter 25 of the General Statutes in 1965. G.S. 25-2-107(2), as amended in 1975, provides that "(a) contract for the sale ... of timber to be cut is a contract for the sale of goods within this article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance."

BACKGROUND: Historically, timber interests have been treated as an interest in real property, and the excise tax on conveyances has been applied to deeds conveying timber. With the adoption of the UCC, the sale of standing timber was deemed to be a sale of goods. There have been two North Carolina cases that have ruled on timber rights since the adoption of the UCC. In *Mills v. New River Wood Corp.*, 77 N.C. App. 576, 333 S.E.2d 759 (1985), the Court ruled that contracts for the sale of "timber to be cut" were governed by G.S. 25-2-107(2). In *Mills,* the cause of action was based on a timber deed, which the Court described as evidencing the underlying contract of sale. In a more recent case, the North Carolina Supreme Court concluded that when North Carolina adopted the UCC, it began classifying timber as goods when timber was the subject of a contract for sale. *Fordham v. Eason,* 521 S.E. 2d 701 (1999).

The recent court decisions have led to disagreement among legal scholars and registers of deeds as to whether contracts for the sale of standing timber and timber deeds constitute a sale of personal property or a sale of real property. The proponents of timber as real property claim that the above court decisions refer to timber as goods under the UCC only when the timber is subject to a contract for sale. The proponents of timber as personal property claim that both contracts and deeds for the sale of timber are governed by G.S. 25-2-107 and, therefore, do not convey an interest in real property. Under current law, the excise tax on conveyances applies only to conveyances of an interest in real property. Consequently, the excise tax should not be imposed on timber deeds or contracts for the sale of standing timber if they are deemed to be sales of personal property.

BILL ANALYSIS: This proposal clarifies that the excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber. For purposes of Article 8E, Excise Tax On Conveyances, the timber will be treated as if it were real property. The proposal remedies any confusion resulting from the court decisions regarding the treatment of timber deeds and

contracts for the sale of standing timber. It is worth noting that the following subsection of G.S. 25-2-107 recognizes that a contract for the sale of standing timber can be treated as a conveyance of real property:

> (3) The provisions of this section are subject to any third-party rights provided by the law relating to realty records, **and the contract for sale may be executed and recorded as a document transferring an interest in land** and shall then constitute notice to third parties of the buyer's rights under the contract for sale. (Emphasis supplied.)

FISCAL ANALYSIS MEMORANDUM

DATE: April 28, 2000

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal 10
Excise Tax on Timber Contracts

FISCAL IMPACT

Yes ( ) **No (X)** **No Estimate Available ( )**

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
EXPENDITURES					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, County Registers of Deeds

EFFECTIVE DATE: Becomes effective July 1, 2000 and applies to timber deeds and contracts for the sale of standing timber executed on or after that date.

BILL SUMMARY: The bill clarifies that the excise tax on instruments conveying real property applies to timber deeds and contracts for the sale of standing timber.

ASSUMPTIONS AND METHODOLOGY: There is no fiscal impact of this bill because it continues the historical tax treatment of timber deeds and contracts as real property. Despite recent court cases that argue timber deeds are personal property, most Registers of Deeds have continued to impose an excise tax on transfers of interests in timber deeds and contracts. (The amount of tax generated from timber deeds cannot be ascertained because Registers of Deeds do not separate timber deeds from other records.)

LEGISLATIVE PROPOSAL 11:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 1999 GENERAL ASSEMBLY, 2000 REGULAR SESSION

AN ACT TO MODIFY THE AUTHORITY OF DEPARTMENT OF REVENUE LAW ENFORCEMENT AGENTS, TO ALLOW THE SECRETARY OF REVENUE TO ADMINISTER THE OATH OF OFFICE TO DEPARTMENT OF REVENUE LAW ENFORCEMENT AGENTS, AND TO PROVIDE A CIVIL PENALTY FOR FILING A FRIVOLOUS INCOME TAX RETURN.

SHORT TITLE: Tax Enforcement.

BRIEF OVERVIEW: The proposal makes three changes to the tax laws:

- It gives the Secretary of Revenue the authority to administer the oath of office to Revenue Law Enforcement agents. The Secretary is not given the general authority under G.S. 11-7.1 to administer oaths. The Secretary does have authority under G.S. 105-261 to administer an oath to a person with respect to a tax return or report.
- It gives Revenue Law Enforcement agents the authority to enforce the following misdemeanor statutes:
  - The willful failure to collect, withhold, or pay over tax.
  - The willful failure to file return, supply information, or pay tax.
  - The use of non-tax-paid fuel for highway use. (G.S. 105-449.117)
  - Misdemeanor acts under G.S. 105-449.120.
  - The sale of cigarettes in North Carolina if the cigarettes were originally manufactured for export to a foreign country.
- It provides a civil penalty of $500 for filing an income tax return that meet both of the following conditions:
  - Fails to include information on which the substantial correctness of the return may be judged or contains information that indicates that the return is substantially incorrect.
  - Evidences a desire to delay or impede the revenue laws of this State or a reliance on a position that is frivolous.

EFFECTIVE DATE: The civil penalty becomes effective October 1, 2000, and applies to returns filed on or after that date. The remainder is effective when it becomes law.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

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LEGISLATIVE PROPOSAL 11
99-LYXZ-073B(4.20)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Tax Enforcement. (Public)

Sponsors: Representatives Miller; Allen, Gray, Hill, Jarrell, Luebke, Pope, and Tucker.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE AUTHORITY OF DEPARTMENT OF REVENUE LAW ENFORCEMENT AGENTS, TO ALLOW THE SECRETARY OF REVENUE TO ADMINISTER THE OATH OF OFFICE TO DEPARTMENT OF REVENUE LAW ENFORCEMENT AGENTS, AND TO PROVIDE A CIVIL PENALTY FOR FILING A FRIVOLOUS INCOME TAX RETURN.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-236.1(a) reads as rewritten:

"(a) General. -- The Secretary may appoint employees of the Criminal Investigations Division to serve as revenue law enforcement officers having the responsibility and subject-matter jurisdiction to enforce the felony and misdemeanor tax violations in G.S. ~~105-236~~ 105-236, to enforce the misdemeanor tax violations in G.S. 105-449.117 and G.S. 105-449.120, and to enforce any of the following criminal offenses when they involve a tax imposed under Chapter 105 of the General Statutes: G.S. 14-91 (Embezzlement of State Property), G.S. 14-92 (Embezzlement of Funds), G.S. 14-100 (Obtaining Property By False Pretenses), G.S. 14-119 (Forgery), ~~and~~ G.S. 14-120 (Uttering Forged ~~Paper).~~ Paper), and G.S. 14-401.18 (Sale of Certain Packages of Cigarettes).

The Secretary may appoint employees of the Unauthorized Substances Tax Division to serve as revenue law enforcement officers having the responsibility and subject-matter jurisdiction to enforce the excise tax on unauthorized substances imposed by Article 2D of this Chapter. To serve as a revenue law enforcement officer, an employee must be certified as a criminal justice officer under Chapter 17C of the General Statutes.

The Secretary may administer the oath of office to revenue law enforcement officers appointed pursuant to this section."

Section 2. G.S. 105-236 is amended by adding a new subdivision to read:

"(10a) Filing a Frivolous Return. -- If a taxpayer files a frivolous return under Part 2 of Article 4 of this Chapter, the Secretary shall assess a penalty in the amount of five hundred dollars ($500.00). A frivolous return is a return that meets both of the following requirements:

a. Fails to include information on which the substantial correctness of the return may be judged or contains information that indicates the return is substantially incorrect.

b. Evidences a desire to delay or impede the revenue laws of this State or a reliance upon a position that is frivolous."

Section 3. Section 2 of this act becomes effective October 1, 2000, and applies to returns filed on or after that date. The remainder of this act is effective when it becomes law.

LEGISLATIVE PROPOSAL 11:
Tax Enforcement

BILL ANALYSIS

Committee:	Revenue Laws	Sponsor:	Rep. Miller
Date:	April 27, 2000	Analysis by:	Y. Canaan Huie
Version:	99-LYXZ-073B		Staff Attorney

SUMMARY: Legislative proposal 11 makes three changes to current law to facilitate enforcement of the tax laws. The section that creates a civil penalty becomes effective October 1, 2000 and applies to offenses committed on or after that date. The remainder is effective when it becomes law.

ANALYSIS:

Section 1. This section makes two changes to the statute that authorized revenue law enforcement officers. First, this section would authorize revenue law enforcement officers to enforce several additional misdemeanors. The misdemeanor offenses that are added are as follows:

1. Willful failure to collect, withhold or pay over tax. G.S. 105-236(8)
2. Willful failure to file return, supply information, or pay tax. G.S. 105-236(9)
3. Use of dyed diesel or other non-tax-paid fuel. G.S. 105-449.117.
4. Miscellaneous fuel tax misdemeanors. G.S. 105-449.120.
5. Sale of certain packages of cigarettes. G.S. 14-401.18.

Currently, revenue law enforcement officers have authority to enforce felony violations under G.S. 105-236 and to enforce numerous other offenses under State law when they involve a State tax.

Second, this section authorizes the Secretary of Revenue to administer the oath of office to revenue law enforcement officers. The Secretary is not one of the individuals who has general authorization under G.S. 11-7.1 to administer oaths. The Secretary does, however, have authority under G.S. 105-261 to administer an oath to a person with respect to a tax return or report.

Section 2. This section creates a civil penalty for filing a frivolous income tax return. In order for a return to be frivolous, it must meet each of the following conditions:

1. The return does not include information on which the substantial correctness of the return may be judged or contains information that indicates that the return is substantially incorrect.

2. The return relies upon a frivolous position or evidences a desire to delay or impede the revenue laws.

The penalty for filing a frivolous return would be five hundred dollars ($500). As with other penalties assessed under Subchapter I of Chapter 105, this penalty would be assessed as an additional tax. This penalty is similar to a penalty imposed on the federal level under section 6702 of the Code.

The Department of Revenue recommended this proposal. The Department has found instances in which a taxpayer will knowingly file an incorrect return in order to inflate deductions and thus increase the amount of a return. An example of this would be a taxpayer that claims extra dependents. Because many of these taxpayers are already due a return, this situation is not adequately covered by penalties currently in effect that deal with a failure to pay a tax.

FISCAL ANALYSIS MEMORANDUM

DATE: May 1, 2000

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal 11
Tax Enforcement

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
General Fund	See Assumptions and Methodology				
EXPENDITURES					

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

EFFECTIVE DATE: Section 2 (frivolous returns) is effective October 1, 2000, and applies to offenses committed on or after that date. The remainder of the act is effective when it becomes law.

BILL SUMMARY: This bill (1) allows the Secretary of Revenue to administer the oath of office to Department of Revenue Law Enforcement Agents, (2) allows Revenue Law Enforcement Agents to enforce misdemeanor tax laws, and (3) creates a $500 civil penalty for filing frivolous income tax returns.

ASSUMPTIONS AND METHODOLOGY: Section one of the bill, granting Revenue Law Enforcement Agents arrest powers in selected misdemeanors, has no fiscal impact. These agents currently investigate all misdemeanor tax cases but depend on local law enforcement officials to make the arrests. There is no additional revenue from penalties.

Section two of the bill creates a $500 civil penalty for filing a frivolous tax return, thus adding North Carolina to a list of 18 states and the Internal Revenue Service that charge a fee for fraudulent taxpayer actions. This penalty applies to persons who knowingly use a tax preparer that guarantees lucrative state and federal income tax refunds by using such schemes as exaggerating the number of dependents or inflating deductions such as medical or charitable contributions.

The Department of Revenue's Criminal Investigations nine person unit currently has six tax preparers under indictment and four tax preparers under investigations. The Director of the unit expects to investigate 6 to 10 cases a year over the next five years. In these cases, it is estimated that each tax preparer fraudulently prepares 100 to 200 income tax returns per year. In 951 civil audits conducted on fraudulent returns filed from 1996 to 1998, the average overpayment of refund was $1,463. While prosecution of these fraudulent returns recovered the overpayments, few penalties were assessed on the taxpayers. As few as 5% of the cases were charged with fraud because of the tremendous staff time needed to provide the evidence necessary for a conviction.

Based on the projected caseload of fraudulent tax preparers (6 to 10 per year) and the number of returns filed illegally by each preparer (100 to 200), the revenue from this $500 civil penalty could range between $300,000 to $1 million a year. (This revenue will be deposited into the General Fund.) This is a rough estimate because of the following factors. First, the revenue the Department now receives from fraud penalties should be netted against this new revenue. Unfortunately, the Department cannot provide the amount of penalty revenue currently received. Second, given the severity of the case, the Department of Revenue might not apply the penalty in every case, thus diminishing the revenue gain. Finally, the frequent application of this penalty to fraudulent taxpayers in the next few years and the publication of this new penalty and taxpayer prosecutions will serve as a deterrent for future tax fraud. Such deterrence of criminal action will reduce the amount of penalty revenue.

APPENDIX A

♦ AUTHORIZING LEGISLATION

♦ TOPICS REFERRED TO REVENUE LAWS IN SEPARATE LEGISLATION

ARTICLE 12L

Revenue Laws Study Committee

§ 120-70.105. Creation and membership of the Revenue Laws Study Committee.

(a) Membership. -- 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.

(b) Terms. -- 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 a successor is appointed. A vacancy shall be filled within 30 days by the officer who made the original appointment. (1997-483, s. 14.1; 1998-98, s. 39.)

§ 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. (1997-483, s. 14.1.)

§ 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 G.S. 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. Upon approval of the Legislative Services Commission, the Legislative Services 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. (1997-483, s. 14.1.)

Issues Referred to Revenue Laws Study Committee
1999-2000

Topics referred by the Legislative Research Commission:

- Consolidated income tax returns by affiliated corporations, including the legal, fiscal, and other effects of consolidated or combined reporting (HJR 491-McMahan: S.L. 99-395, Sec. 2.1(5)a).
- Property tax exemptions for nonprofit institutions (SB 325; S.L. 99-191, Sec. 3) The current property tax exemption for CCRC expires this year. Related to the CCRC issue is the tax exemption for hospitals.

Topics referred by legislation

- Investment Advisors (SB 1010; S.L. 99-395, Sec. 13.1) Regulation and practice of investment advisers.
- Disaster County Tier Rankings (S.L. 99-463, Extra Session, Sec. 4.7) Study the potential consequences of lowering the enterprise area tier designations under G.S. 105-129.3 of counties that sustained severe to moderate damage from a hurricane or a hurricane-related disaster in 1999, according to the Federal Emergency Management Agency.

APPENDIX B

SUMMARY OF 1999 TAX LAW CHANGES

1999 Tax Law Changes

ELIMINATE STAMPS FOR DEED TAX

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-28	HB 56	Representative Hill

AN ACT TO ELIMINATE THE USE OF STAMPS TO INDICATE WHETHER THE EXCISE TAX ON CONVEYANCES HAS BEEN PAID AND TO MAKE THE PENALTIES THAT APPLY TO THIS TAX THE SAME AS FOR OTHER TAXES.

OVERVIEW: This act eliminates the requirement that tax stamps be used to indicate whether the excise tax on conveyances has been paid. It also makes the penalties for failure to pay the tax the same as for other taxes.

FISCAL IMPACT: The act will not affect local or State revenues significantly.

EFFECTIVE DATE: July 1, 2000.

BACKGROUND & ANALYSIS: The excise tax on conveyances, known as the deed stamp tax, is a State tax on instruments transferring an interest in real property. The register of deeds of the county in which the property is located collects the tax when the deed transferring the property is recorded. The person presenting the instrument for recording is responsible for indicating on the instrument the amount of tax due. The register of deeds must collect the tax due and mark on the instrument to indicate payment of the tax and the amount paid. The tax rate is $1.00 for each $500.00 (0.2%) of the value of the property conveyed. The county retains one-half of the net proceeds of the tax and remits the remaining one-half to the State. 75% of the funds remitted to the State is dedicated to the Parks and Recreation Trust Fund created in G.S. 113-44.15 and 25% is dedicated to the Natural Heritage Trust Fund created in G.S. 113-77.7. None of the State's share of the deed stamp tax goes to the General Fund.

Under prior law, the Register of Deeds had to use tax stamps to indicate the tax had been paid. This act removes the requirement that tax stamps be used to indicate the tax has been paid. Tax stamps are no longer the best method for tracking payment of the conveyance tax now that metering machines and similar equipment are available. About 85 of the 100 counties have switched from stamps to more modern methods of tracking the tax. The act does not prohibit a county from using stamps to indicate that the tax has been paid. However, effective July 1, 2000, the Department of Revenue will no longer be responsible

for ordering and maintaining an inventory of various denominations of stamps to sell to the counties that choose to use them.

The act continues the work the legislature began last session when it amended several sections of the Revenue Act to make tax penalties uniform by providing that the civil and criminal penalties applicable to all other State taxes apply to the conveyance tax. Under prior law, willful evasion of the tax was a Class 3 misdemeanor punishable by a fine of between $100 and $1,000. The general penalty contained in Article 9 of Chapter 105 for failure to pay the tax due is 10% of the amount of tax due. The penalty for willfully failing to pay the correct amount of tax due is a Class 1 misdemeanor. Attempting to evade a tax due is punishable as a Class H felony.

The Revenue Laws Study Committee, upon the recommendation of the Department of Revenue recommended this legislation.

CONTINUING CARE RETIREMENT HOMES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-191	SB 325	Senator Hoyle

AN ACT TO MAKE CORRECTIONS AND CONFORMING CHANGES RELATING TO TAXATION OF CONTINUING CARE RETIREMENT HOMES.

OVERVIEW: The act makes corrections and conforming changes to the 1998 legislation that temporarily revised a property tax exemption for continuing care retirement centers (CCRCs), which had been held unconstitutional in 1998. The act makes the following changes retroactive to the 1998 tax year:

- Removes an unconstitutional grandfather clause from the exemption.
- Clarifies that the entity that selects the governing board of the nonprofit CCRC may be a corporation or an unincorporated association.
- Provides that the entity that selects the governing board of the nonprofit CCRC may be a charitable organization, a fraternal beneficiary association, or a domestic fraternal association.
- Discourages counties and cites from collecting prior years' taxes on exempt CCRCs on or after January 1, 1998.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: Changes are retroactive to the 1998 tax year.

BACKGROUND & ANALYSIS: In 1998, the General Assembly exempted from property tax those CCRCs whose governing body is not self-perpetuating but is selected by another publicly supported charitable nonprofit. That act effectively restored the exemption for those CCRCs that were exempt under the law struck down by the North Carolina Supreme Court[1], but retained taxability of those CCRCs that had been taxed all along. It did not affect charitable homes for the aging, which were already exempt and were not affected by the court case.

While the 1998 legislation was in committee, an amendment was added limiting the exemption to those CCRCs who met the definition as of a certain date. Such a grandfather clause in a property tax provision is not a valid classification under the North Carolina Constitution. After the law was enacted, the Institute of Government noted the unconstitutional grandfather clause, and some counties determined that they would not recognize the exemption because it had this unconstitutional provision. This act removes the unconstitutional grandfather clause that limited the property tax exemption to CCRCs whose charter or bylaws met the definition on August 15, 1998.

The act also expands the definition of the appointing entity to include associations and fraternal entities. To qualify for the property tax exemption under the 1998 law, the governing board of the CCRC had to be appointed by a publicly supported charitable 501(c)(3). After the 1998 legislation was enacted, some CCRCs determined that their boards were appointed by nonprofit associations, rather than corporations, and that some of these nonprofits were fraternal (501(c)(8) and (10)) rather than charitable.

The act removes the financial incentive for assessing retroactive taxes on exempt CCRCs. It does so by reducing the annual State reimbursement to a county or municipality for the repeal of the intangibles tax by 110% of the amount of taxes collected in that year on exempt CCRCs for a year prior to the 1998 tax year. This part of the act is repealed effective September 1, 2003, because the five-year discovery period will have expired then.

Lastly, the act authorizes the Legislative Research Commission to study the issue of property tax exemptions for nonprofits and directs the Legislative Research Commission to report its findings and recommendations to the 2000 Session of the 1999 General Assembly. On August 25, 1999, the Legislative Research Commission referred this issue to the Revenue Laws Study Committee.

[1] In re Springmoor, 348 N.C. 1 (1998).

REAL PROPERTY TAX PENALTY

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-297	SB 817	Senator Ballance

AN ACT TO PROVIDE AN EXCEPTION TO THE LATE LISTING PENALTY FOR CERTAIN REAL PROPERTY IN COUNTIES THAT HAVE NOT ADOPTED PERMANENT LISTING AND TO PHASE IN PERMANENT LISTING IN ALL COUNTIES.

OVERVIEW: This act requires the board of county commissioners of each county to install a permanent listing system. (*Note:* The act only applies to the following six counties: Clay, Graham, Swain, Vance, Warren, and Yancey.) It also provides that the 10% late listing penalty will not apply to property that has not been improved or transferred since it was last listed.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: Each of the six counties affected must have a permanent listing system for taxable years beginning on or after July 1, 2004. The prohibition on imposing the 10% late listing penalty is effective for taxes imposed for taxable years beginning on or after July 1, 1999 and sunsets July 1, 2004.

BACKGROUND & ANALYSIS: There are only six counties that have not adopted a permanent listing system for property tax purposes: Clay, Graham, Swain, Vance, Warren, and Yancey. Under a permanent listing system, the assessor rather than the owner is responsible for listing all real property for property tax purposes. The owner of the property does not need to respond to the listing form unless the property has been improved or transferred since the last listing. The 10% late listing penalty does not apply to property listed under a permanent listing system. However, the penalty does apply if the taxpayer fails to furnish the assessor with information concerning improvements to the property not reflected on the listing form.

To encourage counties to install a permanent listing system as soon as possible, the act provides that, effective for taxes imposed for taxable years beginning on or after July 1, 1999, the 10% late listing penalty will not apply to property that has not been improved or transferred since it was last listed. The prohibition on imposing the late listing penalty sunsets July 1, 2004. The late listing penalty applies to property that should have been listed for tax purposes but is not. When the property is "discovered", the property is taxed for the year it was

discovered and the preceding five years it escaped taxation. Each year's taxes are computed separately. A late listing penalty equal to 10% of the amount of the tax for the earliest year the property was not listed is added to the amount of tax due. The penalty is computed separately for each year the failure to list occurred.

TECHNOLOGY COMMERCIALIZATION CREDIT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-305	SB 1110	Senator Rand

AN ACT TO PROVIDE AN INCENTIVE FOR BUSINESSES TO FIND COMMERCIAL USES FOR TECHNOLOGY DEVELOPED BY RESEARCH UNIVERSITIES.

OVERVIEW: This act adds a new investment tax credit, the technology commercialization credit, to the William S. Lee Quality Jobs and Business Expansion Act, effective for taxable years beginning on or after January 1, 2000.[2]

FISCAL IMPACT: Beginning with the 2000-2001 fiscal year, the maximum General Fund revenue loss is expected to be $2.1 million per year.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2000.

BACKGROUND & ANALYSIS: The new investment tax credit is an alternative to the existing 7% tax credit for investing in machinery and equipment. The technology commercialization credit applies only to investments in machinery and equipment used in production based on technology licensed from a research university. In addition, to qualify, the machinery and equipment must be located in a tier one, two, or three enterprise area. Finally, the taxpayer's investment must equal at least $10 million during the taxable year, and must total at least $100 million over a five-year period. If the investment totals between $100 million and $150 million over five years, the technology commercialization credit is equal to 15% of the amount invested. If the investment equals or exceeds $150 million over five years, the technology commercialization credit is equal to 20% of the amount invested. The technology commercialization credit remains available for 10 years of investments at a single location. The taxpayer's eligibility for the technology commercialization credit is

[2] The William S. Lee Quality Jobs and Business Expansion Act, enacted by the General Assembly in 1996, was designed to promote economic development throughout the State by providing various business tax credits. These credits were expanded by the General Assembly in S.L. 1997-277, S.L. 1998-55, and S.L. 1999-360.

based on the Secretary of Commerce's certification that the taxpayer will invest either $100 or $150 million over five years. If the taxpayer does not achieve the certified level of investment, the credit is forfeited. As for the existing investment tax credit, forfeiture of the credit triggers forfeiture of any worker training credit taken for training workers to operate the new machinery and equipment.

The technology commercialization credit is more generous than the existing investment tax credit under the William S. Lee Act in the following ways:

- The existing investment tax credit is 7% of the amount invested. The technology commercialization credit is 15% or 20% of the amount invested, depending upon the size of the investment.
- The existing investment tax credit must be taken in seven annual installments beginning the year after the year the investment is placed in service. The technology commercialization credit may be taken in the year the investment is placed in service.
- The existing investment tax credit applies only to the extent the new investment is not offset by the amount of machinery and equipment the taxpayer either sold or took out of service in the three-year period before the new investment was placed in service. This restriction limits the existing credit to net increases in North Carolina investment, and disallows it for investments, that, in effect, is a replacement or relocation of pre-existing machinery and equipment. The technology commercialization credit is not required to be offset by machinery and equipment sold to another taxpayer if the new owner keeps the machinery and equipment in service in North Carolina. In addition, this new investment tax credit is not required to be offset by machinery and equipment the taxpayer takes out of service if it was in service at a separate location and was used in a business that is not competitive with the technology commercialization business.
- The existing investment tax credit, like all other William S. Lee Act credits, may be taken against the taxpayer's income tax or franchise tax, but not both. The technology commercialization credit may be taken against both income tax and franchise tax. The taxpayer must determine what percentage of the credit will be taken against each tax, and must maintain the same percentage for the purpose of carryforwards. If new investment is made in a second or subsequent tax year, the taxpayer may elect a different percentage with respect to the credit for each tax year. The election is binding.
- The existing investment tax credit, like all other William S. Lee Act credits, may be carried forward for five years unless the investment amount exceeds $150 million over a two-year period, in which case it may be carried forward for 20 years. The technology commercialization credit may be carried forward for 20 years.

ZERO ESC TAX/TRAINING CONTRIBUTION

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-321	HB 275	Representative Redwine

AN ACT TO IMPLEMENT A ZERO UNEMPLOYMENT INSURANCE TAX RATE FOR MORE EMPLOYERS WITH POSITIVE EXPERIENCE RATINGS, AND TO TEMPORARILY REDUCE THE UNEMPLOYMENT INSURANCE TAX BY TWENTY PERCENT FOR MOST EMPLOYERS AND SUBSTITUTE AN EQUIVALENT CONTRIBUTION TO FUND ENHANCED EMPLOYMENT SERVICES AND WORKER TRAINING PROGRAMS.

OVERVIEW: This act makes two changes to unemployment insurance taxes:

- It changes the minimum credit ratio of employers who are granted a zero tax rate from 5% to 4%, effective April 1, 1999.
- It temporarily reduces unemployment insurance taxes for most employers by 20% and levies a corresponding contribution to be used for enhanced reemployment services and worker training programs, effective January 1, 2000. The rate of contribution is the lesser of 20% or a percentage that yields an amount that, when combined with the employer's unemployment insurance taxes, is no greater than the amount of tax the employer would have paid under existing law. These changes will sunset in two years.

FISCAL IMPACT: *See Background & Analysis section.*

EFFECTIVE DATE: Minimum credit ratio change April 1, 1999

Reduce UI Tax/Remployment fund contribution January 1, 2000

BACKGROUND & ANALYSIS:

Minimum Credit Ratio Change. In 1995, the General Assembly set a zero unemployment insurance tax rate for employers with credit ratios of 5% or greater. This act allows more employers to have a zero unemployment tax rate by lowering the threshold from 5% to 4%. The credit ratio is the ratio of an employer's credit balance in the Unemployment Insurance (UI) Fund relative to the employer's payroll. The UI Fund is maintained by the U.S. Treasury and funded by the State unemployment insurance tax. This part of the act is effective

with respect to calendar quarters beginning on or after April 1, 1999. The Employment Security Commission (ESC) recommended this change due to the solvency of North Carolina's UI Fund and the increasing stability of labor markets. As of April 30, 1999, the balance in the Unemployment Insurance Trust Fund stood at $1.22 billion. In addition, a reserve fund contains an additional $200 million, due to the Fund's solvency and North Carolina's low unemployment rate. ESC estimates this change will affect over 10,000 employers, with a tax savings to employers of over $1,000,000 in the first year. With an additional 6,400 employers reaching the 4% credit ratio each year, ESC estimates that 38,000 employers will benefit from this zero tax rate by 2004.

Reduce UI Tax/Reemployment Fund Contribution. The act also reduces the unemployment insurance taxes employers pay to the Employment Security Commission. The reduction is 20% for most employers, slightly less for new employers, and less for roughly 3,400 employers with a high debit ratio. Those employers who pay at a zero tax rate are not affected by this change. The act levies a new tax equal to a percentage of each employer's unemployment insurance tax. The tax is called a "training and reemployment contribution." The percentage rate of the contribution is the lesser of 20% or a percentage that yields an amount that, when combined with the employer's reduced UI tax, is no greater than the amount of UI tax the employer would have paid under the prior law. Thus, when the UI tax reduction and the new contribution are netted, all employers will pay the same or slightly less. These changes become effective January 1, 2000, and sunset January 1, 2002.

It is estimated that the new contribution will generate $22.9 million in FY 1999-2000 and $60.8 million in FY 2000-2001. The new contribution will be credited to a non-reverting account subject to appropriation by the General Assembly. The account is called the "Employment Security Commission Training and Employment Account." The act states the intent of the General Assembly that 4/5 of the proceeds will be appropriated annually from the account to the Department of Community Colleges for nonrecurring expenditures for various worker training programs. The act amends *The Current Operations and Capital Improvements Appropriations Act of 1999* to appropriate from the Employment Security Commission Training and Employment Account to the Community Colleges System Office the sum of $18 million for the 1999-2000 fiscal year and the sum of $48.5 million for the 2000-2001 fiscal year. The act states the intent of the General Assembly that the remaining 1/5 of the proceeds will be appropriated annually from the account to the Employment Security Commission for the costs of collecting and administering the new contribution, and for nonrecurring expenditures for enhanced reemployment services. The act amends the budget bill to appropriate from the Account to the Employment

Security Commission the sum of $4.5 million for the 1999-2000 fiscal year and the sum of $12.1 million for the 2000-2001 fiscal year.

Unemployment insurance taxes 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.

The General Assembly reduced unemployment insurance tax rates in recent years because the balance in the federal trust fund was higher than needed to pay benefits. The tax rates will automatically double when the trust fund balance falls below $800 million. By reducing the unemployment insurance tax rates by 20% for two years, the changes made by this act could cause the balance in the trust fund to fall faster, triggering an automatic tax increase earlier than might otherwise occur. On the other hand, it is hoped that the enhanced reemployment services funded by the new contribution would shorten the average period before a worker is reemployed, thereby reducing benefit payments for the trust fund. The new contribution would sunset automatically if a drop in the trust fund balance triggered an unemployment insurance tax increase.

History of UI Fund Reductions. Since 1992, the General Assembly has enacted the following legislation to reduce the amount of money in the Unemployment Insurance Fund:

- 1992 - suspended the 20% surcharge on unemployment taxes.
- 1993 - cut unemployment taxes for positive rated employers by an average of 30% for any calendar year in which the balance in the Fund equals or exceeds $800,000,000.
- 1994 - cut the unemployment taxes for positive rated employers by an average of 38.7% and cut the unemployment taxes for new employers by 20%.
- 1995 - cut the unemployment taxes for positive rated employers by an average of 23%, set a zero 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.
- 1996 - reduced unemployment taxes in three ways by (1) assigning a one-year zero unemployment insurance tax rate for all positive rated

employers, (2) giving overdrawn employers additional time to make contributions to their accounts so that they may qualify for the zero tax rate in 1996, and (3) permanently reducing the tax rate for new employers from 1.8% to 1.2%.

INTANGIBLES TAX SETTLEMENT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-327	SB 1043	Senator Rand

AN ACT TO PROVIDE FUNDS TO MEET THE REQUIREMENTS OF A CONSENT JUDGMENT UNDER THE INTANGIBLES TAX CASES.

OVERVIEW: This act approves a settlement agreement executed by the Speaker of the House of Representatives and the President Pro Tempore of the Senate on July 8, 1999, in settlement of Smith, et al. v. State, 95 CVS 06715 and Shaver, et al. v. State, 98 CVS 00625. These cases were initiated by taxpayers who paid intangibles tax on stocks for tax years 1990, 1991, 1992, 1993, and 1994, without protesting the payment in a timely manner. The act also appropriates the funds necessary for the refunds.

FISCAL IMPACT:

- Appropriates $200 million on October 1, 1999, from the Savings Reserve Account for fiscal year 1999-2000 to a settlement fund to pay tax refunds claimed by the above taxpayers.
- Directs the General Assembly to allocate the remaining $240 million to the settlement fund by July 10, 2000.

EFFECTIVE DATE: July 20, 1999.

BACKGROUND & ANALYSIS: On July 8, 1999, a settlement agreement was signed by the President Pro Tempore of the Senate, the Speaker of the House of Representatives, and the Class Counsel for the plaintiffs in two pending lawsuits dealing with the question of when refunds should be paid to taxpayers who paid intangibles tax on stocks for the 1990-94 tax years and who did not timely protest payment of this tax. The agreement was in response to two Superior Court of Wake County decisions regarding nonprotester refunds. On May 25, 1999, the superior court held the State liable for $360 million of refunds and interest for the

1991-94 tax years in Smith, et al. v. State of North Carolina, 95 CVS 06715.[3] In a more recent decision, the superior court held that the State was liable for $110 million in refunds and interest for the 1990 tax year in Shaver, et al. v. State, 98 CVS 00625.

On the same day as the July 8, 1999, settlement agreement, the Superior Court of Wake County entered a consent order tentatively approving the settlement agreement. The consent order provides for the following:

- The General Assembly will appropriate $440 million to a settlement fund over the next two years:
    1. The General Assembly must allocate $200 million to the fund before October 1, 1999. This money will be drawn from the Savings Reserve Account.
    2. The General Assembly must allocate the remaining $240 million to the fund by July 10, 2000.
- Within the Settlement Fund, 85% of the funds will be allocated to the "Smith/Shaver Claims Fund Account" and 15% will be allocated to the "Smith/Shaver Administration Account". Interest and earning on all proceeds will be added as principal to the taxpayers' Claims Fund Account.
- The class counsel under the supervision of the court will administer the Settlement Fund.
- No disbursement will be made from the Claims Fund Account until after August 1, 2000.
- Class members will be provided full notice of the terms of the settlement agreement and their rights.
- The State is immune from any further liability for claims brought by taxpayers regarding the payment of intangibles tax on shares of stock under the repealed G.S. 105-203. This statute imposed an intangibles tax on shares of stock and provided a taxable percentage deduction reducing a taxpayer's liability for this tax in proportion to the issuing company's income taxed in North Carolina. In 1997, the North Carolina Supreme Court held the statute unconstitutional because it violated the commerce clause by discriminating against out-of-state companies.
- The Class Counsel will be developing a timetable for implementing the refund procedures and payment to individual taxpayers.

Pursuant to the terms of the above consent order, the act provides for the following appropriations:

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[3] This decision was issued by the superior court on remand from the North Carolina Supreme Court decision in Smith et al. v. State, 349 N.C. 332 (1998). The Supreme Court held that the trial court erred in dismissing the claims of individuals who paid the intangibles tax for the years in question but did not give notice challenging the legality of the tax. The Court remanded the case to the superior court to determine the details.

- $200 million is appropriated from the Savings Reserve Account for the 1999-2000 fiscal year to the Department of the State Treasurer on October 1, 1999. This sum is to go to a reserve for the Smith/Shaver cases and is to be held in reserve for allocation pursuant to the above consent order. The act states the intent of the General Assembly to restore to the Savings Reserve Account the sum of $200 million during the 2000-2001 fiscal year.
- An additional $240 million is allocated no later than July 10, 2000, in accordance with the above consent order.

PHASE II FUNDS/IMMUNITY/TAX EXEMPT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-333	HB 74	Representative Baker

AN ACT TO AUTHORIZE THE APPOINTMENT BY THE SPEAKER OF THE HOUSE OF REPRESENTATIVES AND THE PRESIDENT PRO TEMPORE OF THE SENATE OF MEMBERS OF THE BOARD OF DIRECTORS OF THE CERTIFICATION ENTITY FOR THE PHASE II SETTLEMENT FUNDS, TO PROVIDE THE MEMBERS OF THE BOARD OF DIRECTORS LIMITED IMMUNITY FROM CIVIL LIABILITY, TO PROVIDE AN EXEMPTION FROM STATE INCOME TAX FOR INTEREST, INVESTMENT EARNINGS, AND GAINS OF CERTAIN TRUST FUNDS, TO PROVIDE A CORPORATE INCOME TAX CREDIT FOR MANUFACTURERS PRODUCING CIGARETTES FOR EXPORTATION TO A FOREIGN COUNTRY, AND TO PROHIBIT THE SALE OF CERTAIN PACKAGES OF CIGARETTES.

Overview: The act does the following:

- Board of Directors. It provides for the appointment of the board of directors of a nonprofit corporation that will be the certifying entity to distribute money to tobacco growers and allotment holders in North Carolina. Pursuant to an agreement among four tobacco manufacturers, the manufacturers will pay the sum of $5.15 billion into the National Tobacco Grower Settlement Trust over a twelve-year period. This trust will provide payments to tobacco growers and allotment holders in fourteen grower states, including North Carolina. This money, referred to as Phase II settlement funds, will be used to ameliorate potential adverse economic consequences of likely changes in the tobacco market on grower states. This provision became effective July 22, 1999.
- Board of Directors' Immunity. It provides immunity to the board of directors for certain acts or omissions arising out of the performance of the

member's duties as a member of the nonprofit corporation. This provision became effective July 22, 1999.

- Income Tax Exemption. It provides an income tax exemption for the interest, investment earnings, and gains of a trust that is established to compensate those who suffer economic loss as a result of a settlement agreement between the State and one or more manufacturers to settle claims of the State against the manufacturers for damages arising from a product of the manufacturers. This change is effective for taxable years beginning on or after January 1, 1999.
- Corporate Income Tax Credit. It creates a corporate income tax credit for manufacturers who produce cigarettes for exportation to a foreign country. The amount of the credit varies depending upon the amount of cigarettes exported in the tax year compared to the amount exported in 1998. This credit is effective for taxable years beginning on or after January 1, 1999, and sunsets for cigarettes exported on or after January 1, 2005.
- Unlawful to Sell Certain Cigarettes. It makes it unlawful to sell cigarettes in North Carolina if the cigarettes were originally manufactured for export to a foreign country. The Secretary of Revenue is authorized to cancel the license or certificate of registration of a person who violates this law. This change is effective December 1, 1999, and applies to offenses committed on or after that date.

FISCAL IMPACT: The above tobacco export credit and tax exemption for the earnings of the settlement trust fund are expected to reduce General Fund revenues by $8.7 million in fiscal year 1999-2000, $9 million in fiscal year 2000-2001, $9.3 million in fiscal year 2001-2002, $9.6 million in fiscal year 2002-2003, and $9.9 million in fiscal year 2003-2004.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

History of the Master Settlement Agreement. On November 23, 1998, forty-six states, including North Carolina, and four tobacco manufacturers signed a Master Settlement Agreement, that settled existing and potential claims of the states against the manufacturers for damages arising from the tobacco products of the manufacturers.[4] The manufacturers agreed to make payments to the states totaling $206 billion through the year 2025. Pursuant to the terms of the Master Settlement Agreement, North Carolina and the four tobacco manufacturers

[4] The four tobacco manufacturers are Phillip Morris, Inc., R. J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company.

entered into a consent decree, filed in Wake County Superior Court on December 21, 1998. State of North Carolina v. Phillip Morris, Incorporated, et al., 98 CVS 14377. This consent decree directed the Attorney General to create a nonprofit corporation for purposes of receipt and distribution of 50% of the funds allocated to North Carolina under the Master Settlement Agreement. The consent decree also required that the creation of the corporation had to be approved by the General Assembly. On March 16, 1999, the General Assembly in Senate Bill 6 (S.L. 1999-2) approved the creation of a nonprofit corporation to distribute 50% of Phase I of the settlement funds allocated to North Carolina. S.L. 1999-2 directs that these funds be used for the public charitable purposes of providing economic impact assistance to economically affected or tobacco-dependent regions of the State. S.L. 1999-2 further states the intent of the General Assembly to allocate the remaining 50% of the Phase I settlement funds as follows:

- 25% to a trust fund to be established by the General Assembly for the benefit of tobacco producers, tobacco allotment holders, and persons engaged in tobacco-related businesses.
- 25% to a trust fund to be established by the General Assembly for the benefit of health.[5]

Under the terms of the Master Settlement Agreement, the four manufacturers also acknowledged the adverse effect that the terms of the Agreement would have on the tobacco grower community. The Agreement contains provisions, such as market restrictions, that are expected to result in a decline in demand for tobacco products. As part of the consideration for settling the claims, the Agreement obligated the manufacturers to address these economic concerns of the tobacco growers and tobacco quota holders.

To meet the obligation, the manufacturers agreed to establish a trust called the National Tobacco Grower Settlement Trust. They agreed to pay up to $5.15 billion over the next twelve years into the Trust, referred to as Phase II settlement funds. Proceeds of the Trust would be allocated directly to tobacco growers and tobacco allotment holders in fourteen grower states, including North Carolina, based on a plan developed by a nonprofit corporation in each state composed of government leaders and public members. The Superior Court of Wake County must approve the trust and the payments made under it.[6]

The trust is designed to be a qualified settlement fund under the Internal Revenue Code. As such, it is taxable as a corporate taxpayer at the tax rate of a

[5] As of August 1999, the General Assembly had not established trust funds for the remaining 50% of the Phase I settlement funds.

[6] A court settlement was signed in Wake County Superior Court on August 20, 1999, approving the settlement of the Phase II funds and the distribution of the payments out of these funds to the fourteen grower states.

trust. The primary benefit of being a qualified settlement fund is that the manufacturers who contribute the principal to the fund may claim a tax deduction on the contributions when they are paid into the fund. If it is determined that the trust does not meet the requirements of a qualified settlement fund, the trust's taxation does not change because contributions to a trust are not included in its gross income. However, the manufacturers would not be able to claim a deduction for their contributions until the money was distributed to the growers and quota holders.

For federal and state tax purposes, the contributions to the trust are tax-exempt. To calculate North Carolina taxable income for both corporations and trusts, one begins with federal taxable income. Since the contributions are not included in income for federal tax purposes, they are not included in income for State tax purposes. However, the interest, investment earnings, and gains of both a qualified settlement fund and a trust are taxable for federal and State tax purposes. Some states exempt qualified settlement funds from state income tax. Locating the settlement fund in a state that does not tax it can maximize the amount of funds distributed to those who suffer economic loss because of the Master Settlement Agreement. Because of North Carolina's role in producing the economic loss, and the desire to have the settlement fund located in this State, the act exempts the interest, investment earnings, and gains of the settlement fund from State income tax.

Provisions of the act. The act carries out the management and distribution of the Phase II funds as follows:

- Board of Directors/Immunity. It authorizes the Speaker of the House of Representatives to appoint one State Representative and the Senate Pro Tempore to appoint one State Senator to the certification board. This is the board that will determine how the Phase II funds will be distributed to North Carolina tobacco farmers and allotment holders. The other members of the board are the Governor, the Commissioner of Agriculture, the Attorney General, two members of the North Carolina congressional delegation selected by the delegation, and four to seven citizens appointed by the Governor. The act provides for limited immunity from liability for the members of the board while performing their duties on behalf of the board. Immunity is not provided for intentional wrongdoing, willful or wanton misconduct, or motor vehicle accidents. Since the board will be a private board, not a State agency, its members will not be covered by the liability insurance coverage the State obtains for its officers and employees.
- Corporate Income Tax Deduction. It provides for a corporate income tax deduction from federal taxable income on the interest, investment

earnings, and gains earned on funds in a qualified settlement fund that meets the following conditions:

1. The settlors of the fund are two or more manufacturers that signed a settlement agreement with North Carolina to settle existing and potential claims of the State against the manufacturers for damages attributable to a product of the manufacturers.
2. The purpose of the fund is to address potential adverse economic consequences resulting from a decline in demand of the manufactured product expected to occur because of market restrictions and other provisions in the settlement agreement.
3. A court of North Carolina approves and retains jurisdiction over the fund.
4. Certain portions of the distributions from the fund are made in accordance with certifications that meet the criteria in the settlement agreement and are provided by a nonprofit entity, the governing board of which includes State officials

- Income Tax Deductions for Trusts. It provides for an income tax deduction for trusts similar to the above deduction. The provision for a tax deduction is set out in both the corporate and trust income tax statutes in case it is determined that the trust does not meet the requirements of a qualified settlement fund.
- Corporate Income Tax Credit/Cigarette Exportation. It allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries. The credit is a dollar amount per cigarette exported for those manufacturers who export at least 50% as many cigarettes in the taxable year as they did in calendar year 1998. The dollar amount ranges from forty cents to twenty cents per 1,000 cigarettes exported. The credit is capped at the lesser of $6 million per year or 50% of the manufacturer's corporate tax liability for any given year. Prior to enactment of the act by the General Assembly in the 1999 Session, the issue was raised as to whether or not this tax credit violates GATT, one of the international trade agreements. The General Assembly staff was of the opinion that the tax credit violates GATT, while counsel for one of the four tobacco manufacturers disagreed. It is clear, however, that any challenge to the credit must come from a foreign government. If a foreign government challenges the credit, then the U.S. Justice Department may sue North Carolina. If the Department wins, then federal statute provides that relief is prospective only and persons who have already used the credit cannot be required to repay it. Private citizens have no cause of action on the issue.
- Unlawful to Sell Certain Cigarettes. It prohibits the sale in North Carolina of a package of cigarettes that meets one or more of the following descriptions:

1. The package differs from the labeling requirements of federal law.
2. The package is labeled "For Export Only", "U.S. Tax Exempt", "For Use Outside U.S.", or with similar wording.
3. The package was altered by adding or deleting the wording described in the above two descriptions.
4. The package was imported into the United States after January 1, 2000, in violation of federal law.
5. The package violates federal trademark or copyright laws.

A violation of this law is a Class A1 misdemeanor and an unfair trade practice. A package of cigarettes that violates this law is considered contraband and may be seized by a law enforcement officer. The Secretary of Revenue is authorized to cancel the license or the certificate of registration, whichever is applicable, of a person who violates this law.

REVENUE LAWS TECHNICAL CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-337	SB 55	Senator Cochrane

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES.

OVERVIEW: This act makes numerous technical and clarifying changes to the revenue laws and related statutes as recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: July 22, 1999, unless otherwise provided *(see Background & Analysis section).*

BACKGROUND & ANALYSIS: The following table provides a section-by-section analysis of the changes:

SECTION	*EXPLANATION*
1	Corrects an incorrect effective date for the income tax treatment of enhanced wireless 911 fees.
2	Updates list of debtors' property that is retained free of creditors' claims, to add Roth IRAs to regular IRAs and to update terminology for regular IRAs.
3	Reinstates increase in notary commission fee from $25 to $30

SECTION	EXPLANATION
	that was enacted in the 1998 budget bill but was deleted inadvertently by another 1998 bill. This fee increase became effective October 1, 1999.
4 - 11	Changes references to the inheritance tax, which was replaced with an estate tax effective for the estates of decedents dying on or after January 1, 1999.
12	Corrects a grammatical error by deleting the word "or" in G.S. 93B-15.
13	Deletes language in G.S. 105-32.8 that a person "is subject to the penalties in G.S. 105-236" when that person fails to report a federal correction or determination of the maximum state death tax credit allowed an estate or of the maximum state generation-skipping transfer tax credit allowed. Failure to report to the Secretary of Revenue would still result in forfeiture of the right to any refund due by reason of the determination. Since repeal of the inheritance tax laws, there are no penalties in G.S. 105-236 that apply to this section.
14	Combines G.S. 105-37.1 (Amusements) and G.S. 105-38 (Amusements-Circuses and other traveling amusements) into one statute. These are the amusements subject to 3% gross receipts tax.
15	Moves the language that exempts certain motion pictures from the privilege tax imposed on motion pictures in G.S. 105-38.1 to the list of exemptions in G.S. 104-40 (Amusements exempt from tax).
16	Repeals G.S. 105-109.1 because it is no longer needed. This statute provides that interest will be assessed on the taxes on gross receipts levied on amusements in G.S. 105-37.1 and G.S. 105-38, the tax on installment paper dealers, and the tax on publishers of newsprint publications. This interest runs from the time these taxes were due until paid. This statute is no longer needed now that Article 9 (General Administration; Penalties and Remedies) applies to the privilege license statutes. This repeal also clarifies that interest applies to late payments of the 1% gross receipts tax on movies.
17	Repeals G.S. 105-113 because it is obsolete. This statute requires the sheriff of each county and clerk of the board of alderman of each city to make an annual report to the Secretary of Revenue containing the name and business of every person in the county or city required to obtain a State license under Article 2 of Chapter 105 of the General Statutes.
18	Clarifies that the possession of more than six hundred cigarettes

SECTION	EXPLANATION
	on which tax has been paid to (was "bearing the tax stamp of") another state or country, by any person other than a licensed distributor, is prima facie evidence that the cigarettes are possessed in violation of this State's tobacco products tax. The underlined language clarifies how the Department currently administers this law. This change is needed because there are states that do not use stamps.
19	Updates the statutory cross-references in the Unauthorized Substance tax law.
20	Clarifies scope of franchise tax to include savings and loan associations, as enacted in 1998.
21	Clarifies that a corporation that owes franchise tax but not income tax must apportion its franchise tax using the apportionment formula that would apply to income tax if the corporation were subject to that tax. The law is silent on this issue, and this new language sets out the Department's position.
22	Removes a reference to G.S. 105-130.17 concerning the form of an affirmation because the subsection in that statute pertaining to the form of the affirmation was repealed in 1998. It provides that the affirmation must be in the form required by the Secretary. It also modernizes statutory language. The reference to G.S. 105-236 is unnecessary because the administrative provisions in G.S. 105-236 automatically apply to the corporate income tax statutes.
23	Restores the word "generator" which was inadvertently deleted in 1998. This statute was later repealed by S.L. 1999-342.
24	Changes "Division" to "Part" to conform to new terms enacted in 1998.
25	Changes the reference to the Code section in G.S. 105-152(e). This statute concerns joint tax liability and the innocent spouse. In the IRS Restructuring Act of 1998, the Code section 6013(e) was deleted and substituted in section 6015.
26	Removes reference to repealed statute.
27	Changes "Division" to "Part" to conform to new terms enacted in 1998.
28	Transfers the definitions of "moped" and "special mobile equipment" from Chapter 20 to the sales tax statute in Chapter 105, and then places a cross-reference to the sales tax statute in Chapter 20. These items are subject to sales tax. The Department of Revenue, rather than the DMV, administers the sales tax on special mobile equipment.

SECTION	EXPLANATION
29	Adds the term "card-operated" to the sales tax exemption from receipts derived from coin or token-operated washing machines, extractors, and dryers. New technology permits the use of credit and debit cards on this equipment, and the Department has administratively allowed the sales tax exclusion for equipment operated with cards.
30	Clarifies that the certificate of registration filed with the Department by a retailer who makes taxable sales is void if for a period of 18 months the retailer files no returns or files returns showing no sales. Some retailers make only wholesale sales or exempt sales. Those retailers do not need to file sales tax returns and their certificate should not be void because they fail to file a return for a period of 18 months. There was a similar provision in the law prior to its rewrite last session.
31	Deletes the word "burlap" from the reference to the sales tax exemption for the lease or rental of burlap tobacco sheets used in handling tobacco in the warehouse and transporting tobacco to and from the warehouse. This change is necessary because tobacco sheets are now made of other material.
32	Clarifies the filing requirement for the excise tax on piped natural gas. Payment is required monthly and a return is required quarterly. The Department is currently administering the filing requirement this way.
33	Changes references to the inheritance tax, which was replaced with an estate tax effective for the estates of decedents dying on or after January 1, 1999.
34	Adds reference to limited liability companies to conform to remainder of statute.
35	Revises and recodifies a statute that included redundant references to the taxability of property transferred to a tax-exempt nonprofit corporation.
36	Changes statutory references to conform with the movement of the definitions from Chapter 20 to Chapter 105 made in section 28 of this act.
37-42	Deletes references to the "annual filing" of motor carrier reports. The Department of Revenue does not allow annual filing because of the International Fuel Tax Agreement requirements. The reports must be filed quarterly. They also change the reference to motor fuel from "gasoline and other motor fuel" to "motor fuel and alternative fuel". These references were not changed when tax at the rack was enacted in 1995 and need to be updated. Section 41 also conforms the

SECTION	EXPLANATION
	registration of motor carriers with the current administrative practice.
43-44	Conforms motor fuel penalty-hearing statute to other hearing procedure statutes. Also clarifies that a request for a hearing must explain why the person is not liable for the penalty.
45	Corrects an incorrect statute reference.
46	Savings clause
47	Effective date

OMNIBUS ESC CHANGES

Session Law #	Bill #	Sponsor
S.L. 1999-340	HB 276	Representative Redwine

AN ACT MAKING VARIOUS CHANGES TO THE EMPLOYMENT SECURITY LAWS OF NORTH CAROLINA.

OVERVIEW: This act contains a number of changes recommended by the Employment Security Commission. It includes the following tax law changes, which became effective July 22, 1999, as well as technical and conforming changes:

- Section 1 authorizes electronic funds transfer and credit card payments for unemployment insurance taxes.
- Section 2 extends the requirement for automated filing of employee information in the "Employer's Quarterly Tax and Wage Report" to employers with 100 or more employees.
- Section 8 authorizes the Department of Revenue to share with the Employment Security Commission additional taxpayer information for use in the NC WORKS study and Section 10 prohibits the Commission from disclosing this information.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: July 22, 1999.

BACKGROUND & ANALYSIS:

EFT/Credit Card Payments. Before enactment of this act, the employment security law contained no provisions allowing payment of unemployment

insurance contributions by electronic funds transfer (EFT) or by credit card. Section 1 of this act authorizes employers to utilize EFT for paying unemployment insurance contributions. The act defines "EFT" as a transfer of funds using an electronic terminal, a telephone, a computer, or magnetic tape to instruct or authorize a financial institution to credit or debit an account. This definition is identical to the definition of EFT that applies in the Revenue Act, as provided in G.S. 105-228.90. Section 1 also authorizes the Employment Security Commission to establish policies to permit employers to pay unemployment insurance contributions by credit card. The policies must require the employer to pay any fee charged to the ESC for use of the card.

Automated Filing of Employee Information. Under prior law, an employer with 250 or more employees, and an agent who reports wages for an employer with 250 or more employees, must file the employee information portion of the quarterly tax and wage report on magnetic tapes or diskettes, as prescribed by the Employment Security Commission. Section 2 of this act extends the electronic filing requirement to employers with 100 or more employees, and to their reporting agents.

Information for Use in NC WORKS Study. G.S. 108A-29(r) requires each county's Job Service Employer Committee or Workforce Development Board to study the working poor in that county and report annually to various oversight committees of the General Assembly. This report is called the NC WORKS report. The tax secrecy law authorizes the Department of Revenue to disclose individual income taxpayer information to the Employment Security Commission in order to assist the county committees and boards with the report. The Employment Security Commission may use the information only in a nonidentifying form for statistical and analytical purposes. The prior law authorized the Department of Revenue to share the following information: name, social security number, spouse's name, county of residence, filing status, federal personal exemptions, federal taxable income and North Carolina additions to it, North Carolina income, and total income. Section 8 of this act expands the type of information that may be shared to include spouse's social security number, exemption for children, nonresidents' and part-year residents' exemption for children, credit for children, and detailed information related to the credit for child care and employment-related expenses. Section 10 of this act clarifies that this information is subject to the same confidentiality law as other tax information obtained by the Employment Security Commission.

USE TAX PAYMENT/OTHER CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-341	HB 1433	Representative Miller

AN ACT TO PROVIDE FOR INDIVIDUALS TO PAY THEIR ANNUAL USE TAX WITH THEIR INCOME TAX FORMS, TO PROMOTE ELECTRONIC FILING, AND TO IMPROVE TAX COLLECTION.

OVERVIEW: This act simplifies use tax collection and seeks to improve tax collection in several ways:

- It provides that an individual who owes use tax to the State on non-business purchases can pay the tax with the individual's income tax return.
- It promotes the electronic filing of semimonthly sales tax reports.
- It directs the Secretary of Revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities.
- It directs the Department of Revenue and the State Controller to study the feasibility of a central collection operation.
- It prohibits State agencies from contracting with a vendor who is required under G.S. 105-164.8(b) to collect State sales and use tax but refuses to do so.

FISCAL IMPACT: The act is expected to increase General Fund revenues by $1.67 million in fiscal year 1999-2000, $1.75 million in fiscal year 2000-2001, $1.84 million in fiscal year 2001-2002, $1.93 million in fiscal year 2002-2003, and $2.03 million in fiscal year 2003-2004.

EFFECTIVE DATE: *See Background & Analysis section.*

BACKGROUND & ANALYSIS: North Carolina has a State and Local sales and use tax at the combined rate of 6%. (The combined rate is 6 ½ % in Mecklenburg County.) The sales tax is paid on purchases made in this State. The tax is collected by the retailer and remitted to the State. The use tax complements the sales tax by taxing transactions that 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 use tax to the Department of Revenue is also on the purchaser.

The 1997 General Assembly enacted S.L.1997-77, which established an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-state purchases. This change relieved consumers of the need to file

either monthly or quarterly returns. *(For additional background information on use taxes, see below.)*

Use Tax Payable on Income Tax Returns. The act further simplifies use tax collection by providing that the use tax will be paid on the taxpayers' income tax returns. An individual who owes use tax on nonbusiness purchases and who must remit a State income tax return must pay the use tax owed with the income tax return. The income tax return will have space on it to indicate the amount of use tax owed. By placing the use tax on the individual income tax return, as opposed to a separate use return sent to the taxpayer with the income tax return, it is hoped that taxpayers' awareness of their responsibility to pay the tax will increase since taxpayers must affirm that the information on the income tax return is true and complete by signing the return. The Secretary of Revenue is required to provide information on the individual income tax form and instructions to explain a person's obligation to pay use tax on items purchased from mail order, Internet, or other sellers that do not collect State sales tax on items. The Secretary must also provide a method to help a person determine the amount of use tax owed. This method must list categories of items that are commonly sold by mail order or Internet and must include a table that gives the average amounts of use tax payable by taxpayers in various income ranges.

This portion of the act is effective for taxable years beginning on or after January 1, 1999.

Use of Use Tax Revenue. The act allows the Department of Revenue to use some of the additional use tax revenue collected under it to promote tax collections as follows:

- The Department may use $150,000 to pay for the costs of programming, form revision, and resources for taxpayer assistance in connection with the new use tax collection method.
- The Department may use $500,000 to implement a program to allow semimonthly sales and use taxpayers to file their returns electronically.
- The Department may use some of the revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities. A delinquent tax debt is the amount of tax due as stated in a final notice of assessment issued to the taxpayer when the taxpayer no longer has the right to contest the debt. The Department must report on its collections pursuant to this contract to the Revenue Laws Study Committee.
- The Department may use up to $50,000 to conduct a study, in cooperation with the State Controller, to identify and evaluate proposals for more efficient collection of taxes. The Department must report is findings, recommendations, and estimated revenue gains to the Revenue Laws Study Committee by May 1, 2000.

State Contracts with Certain Vendors Prohibited. Effective July 1, 1999, the State is prohibited from contracting with a vendor for goods or services if the vendor is required by G.S. 105-164.8(b) to collect use tax for the State but refuses to do so. G.S. 105-164.8 requires a retailer that is engaged in business in this State to collect use tax on a mail order sale. Subsection (b) of this statute provides that a retailer that makes a mail order sale is engaged in business in this State if the retailer meets one or more of the following conditions:

- Is a corporation engaged in business under the laws of this State.
- Maintains offices in this State.
- Has representatives in this State who solicit business or transact business on behalf of the retailer.
- Is purposefully or systematically exploiting the market in this State by any media-assisted, media-facilitated, or media-solicited means, including direct mail advertising, distribution of catalogs, computer-assisted shopping, etc.
- Resides in a jurisdiction that has a compact or reciprocity with North Carolina to support North Carolina's taxing power.
- Consents to the imposition of the collection of the tax.

Disclosure of Information. Effective July 1, 1999, the act also amends the tax secrecy provisions to allow the Secretary of Revenue to make two disclosures.

1. The Secretary may provide the Secretary of Administration with a list of vendors who refuse to collect the State's use tax even though they are required to do so under G.S. 105-164.8.
2. The Secretary may provide the public with access to a database containing the names and account numbers of taxpayers who are not required to pay sales and use tax because of an exemption or because they are authorized to pay the tax directly to the Department.

Additional Background on Use Tax Collections: In the 1980s, states around the country became increasingly aware of the revenue loss associated with taxpayer avoidance of the use tax. The potential increase in State and local revenue for North Carolina, if full taxpayer compliance were achieved, would exceed $100 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 National Bellas Hess Inc. v. Department of Revenue that a state could 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.

States have negotiated with direct marketers on at least two occasions to craft a voluntary collection agreement where marketers would collect the tax and states would simplify their reporting requirements. Both of these efforts were unsuccessful.

There are three efforts currently under way to address the issue of out-of state purchases:

- The National Tax Association Communications and Electronic Commerce Tax Project is focusing on a simplified multi-state approach to sales and use taxation of remote sellers which would require states to adopt common definitions of tax base components and impose a single tax rate statewide.
- The Advisory Commission on Electronic Commerce was established by the Internet Tax Freedom Act. This Act was part of the omnibus federal budget bill signed into law on October 21, 1998. The Advisory Commission has 18 months from this date to study electronic commerce issues and to make a report to Congress.
- The Multistate Tax Commission Tax Simplification Project is comprised of representatives of business and state and local governments who are focusing on ways to simplify the sales and use tax in the areas of uniformity and reporting. The act contains several recommendations made to the Project by the North Carolina representatives. These recommendations are (1) the promotion of electronic filing of semimonthly sales and use tax reports, (2) the authority of the Secretary of Revenue to provide the Secretary of Administration with a list of vendors who refuse to collect the State's use tax even though the vendors are required by law to collect the tax, and (3) the authority of the Secretary of Revenue to provide the public with access to a database containing the names and account numbers of taxpayers who are not required to pay sales and use tax.

SIMPLIFY RENEWABLE ENERGY CREDITS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-342	HB 1472	Representative Hackney

AN ACT TO SIMPLIFY AND MODERNIZE TAX CREDITS FOR INVESTING IN RENEWABLE ENERGY SOURCES.

OVERVIEW: This act repeals nine corporate and individual income tax credits relating to energy savings devices and replaces them with a tax credit for investing in renewable energy property.

FISCAL IMPACT: The effect of this act on General Fund revenues cannot be estimated.

EFFECTIVE DATE: The act becomes effective beginning with the 2000 taxable year.

BACKGROUND & ANALYSIS: The General Assembly enacted several individual and corporate income tax credits in the 1980s to encourage the following energy saving investments:

- Solar energy equipment.
- Conversion of industrial boilers to wood fuel.
- Peat facility.
- Olivine brick facility.
- Methane gas facility.
- Wind energy device.
- Hydroelectric generator.

Of these credits, there is no evidence that the ones for peat, wind energy, olivine bricks, and methane have ever been used. This act repeals nine income tax credits for these types of property and substitutes a general credit for investing in renewable energy property. The new credit applies to a broader category of property and is, generally, more generous than the prior law credits. The intent of the act is that the broader category of renewable energy property will reflect technological advances in renewable energy and that the more generous credit percentages, caps, and carryforwards will encourage more investment in renewable energy property.

The credit percentage for the prior law credits ranged from 10% to 40% of the taxpayer's investment; the new credit percentage is 35% of the investment. Most of the prior law credits were capped at between $1,000 and $25,000 per installation. The renewable energy credit is capped at between $1,400 and $10,500 for residential installations and at $250,000 per installation for nonresidential installations (although the credit must be taken in five annual installments unless it is for a single family dwelling installation). The prior law credits were allowed against income tax only; the renewable energy credit is allowed against either income or franchise tax, but may not exceed 50% of the taxpayer's tax liability for a taxable year. Only about half of the prior law credits

allowed carryforwards; the renewable energy credit may be carried forward for five years.

The act defines renewable energy property as any of the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, and animal wastes.
- Hydroelectric generators.
- Solar energy equipment.
- Wind equipment.

The amount of the credit is 35% of the cost of the property placed in service. In the case of renewable energy property that serves a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The credit may not exceed the following amounts:

TYPE OF PROPERTY	*MAXIMUM CREDIT*
Nonresidential Property	$250,000 per installation
Residential Property - Solar energy equipment for domestic water heating	$1,400 per dwelling unit
Residential Property - Solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating	$3,500 per dwelling unit
Residential Property - All other renewable energy property for residential purposes	$10,500 per installation

The credit is patterned after the business tax credit and is codified in the same Article. Like the business tax credit, the renewable energy tax credit has the following limitations and conditions:

- The renewable energy tax credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward for the succeeding five years.
- A taxpayer that claims any other credit allowed with respect to renewable energy property may not take the renewable energy tax credit with respect to the same property.

- A taxpayer may not take the renewable energy tax credit if the taxpayer leases the property from another person, unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to this property.
- The Department of Revenue must report each year on the number of taxpayers claiming the credits, the cost of the property for which the credits were claimed, and the total cost to the General Fund of the credits claimed.
- The business tax credit is repealed effective January 1, 2002, while the remainder of the Article is repealed effective January 1, 2006. Consequently, the renewable energy tax credit is set to sunset on January 1, 2006.

Prior Credits Repealed. The following chart lists the prior law credits repealed by this act:

G.S.	*SHORT TITLE*	*%*	*CEILING*	*CARRY-FORWARD*
105-130.23.	Credit against corporate income tax for solar energy equipment in residential buildings.	40%	$1,500 per unit	Five years
105-151.2.	Credit for solar energy equipment.	40%	$1,500 per unit	Five years
105-130.26 & 105-151.5.	Credit for conversion of industrial boiler to wood fuel.	15%	None	Five years
105-130.27A.	Credit for construction of a peat facility.	20%	None	Five years
105-130.29.	Credit for construction of an olivine brick facility.	20%	None	Five years
105-130.30 & 105-151.10.	Credit for construction of a methane gas facility.	10%	$2,500 per installation	None
105-130.31 & 105-151.9.	Credit for installation of a wind energy device.	10%	$1,000 per installation	None
105-130.32 & 105-151.8.	Credit for installation of solar energy equipment for the production of heat or electricity in certain processes.	35%	$25,000 per installation	None
105-130.33 & 105-151.7.	Credit against corporate income tax for installation of a hydroelectric	10%	$5,000 per installation	None

G.S.	SHORT TITLE	%	CEILING	CARRY-FORWARD
	generator.			

NEWSPRINT TAX CREDIT CHANGE

Session Law #	Bill #	Sponsor
S.L. 1999-346	HB 1479	Representative Miller

AN ACT TO AMEND THE NEWSPRINT RECYCLING TAX.

OVERVIEW: This act modifies the excise tax on virgin newsprint by postponing the increase in the percentage of recycled content required and by expanding the credit for recycling.

FISCAL IMPACT: The act is expected to reduce revenues in the Solid Waste Management Trust Fund by less than $1,000 per year.

EFFECTIVE DATE: July 1, 1999

BACKGROUND & ANALYSIS: A publisher must pay a privilege license tax of $15 for each ton of newsprint it consumes that does not have a minimum recycled content. The General Assembly enacted this excise tax on newsprint in 1991 to encourage the use of recycled newsprint. The minimum amount of recycled paper required has been phased up since 1991 from 12% to 35% and was set to increase to 40% in 2001. This act delays this increase in the minimum recycled content percentage until 2005.

There is a credit that can be used towards the recycled content percentage goals for publishers who develop and operate, or contract for the operation of, a newspaper recycling program. Under prior law, a publisher could receive one-half ton credit toward its total recycled content tonnage for each ton of newsprint it recycled. This act increases the credit from one-half ton to one ton, and expands it to include recycling of magazines as well as newsprint.

The proceeds of the tax are earmarked for the Solid Waste Management Trust Fund[7]. The tax generates less than $2,000 a year in revenue. The tax does not

[7] The money in this Fund is used to fund activities of the Department of Environment and Natural Resources (DENR) to promote waste reduction and recycling, to fund research on the solid waste stream in North Carolina, to fund activities related to the development of secondary materials markets, to fund demonstration projects, and to fund research by in-State colleges and universities.

apply if the producer cannot meet the recycled content goal because of an inability to obtain newsprint made from recycled paper at a price or quality comparable to other newsprint, to acquire an amount needed for a publication, or to acquire the amount needed in a reasonable amount of time.

MOTOR VEHICLE TAX VALUE/E&R BOARD

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-353	HB 315	Representative C. Wilson

AN ACT TO PROVIDE THAT A MOTOR VEHICLE'S PROPERTY TAX VALUE IS DETERMINED AS OF JANUARY 1 PRECEDING THE DUE DATE OF THE TAX AND TO AUTHORIZE THE STOKES BOARD OF EQUALIZATION AND REVIEW TO MEET AFTER ITS FORMAL ADJOURNMENT.

OVERVIEW: This act provides that a classified motor vehicle's property tax value is to be determined on January 1 of the year the taxes are due, effective for taxes imposed for taxable years beginning on or after July 1, 2000. The act also extends the authority of the Stokes County Board of Equalization and Review to meet after its adjournment upon completion of its duties to examine and review the county's tax list for the current year and to hear a request from a taxpayer regarding the taxpayer's property appraisal or listing.

FISCAL IMPACT:

- Motor vehicle tax value change: This change does not affect General Fund revenues but is expected to reduce local government revenues by $27.6 million in fiscal year 2000-2001, $29.5 million in fiscal year 2001-2002, $31.6 million in fiscal year 2002-2003, and $33.8 million in fiscal year 2003-2004.
- Stokes Co. E&R Bd. Change: No fiscal impact.

EFFECTIVE DATE:

- Motor Vehicle Tax Value Change: Effective for taxes imposed on taxable years beginning on or after July 1, 2000.
- Stokes County E&R Bd. Change: July 22, 1999.

BACKGROUND & ANALYSIS:

Motor Vehicle Property Tax Change. The act changes the date for the determination of the property tax value of a classified motor vehicle from

January 1 preceding the date the new registration is applied for or the current registration expires to January 1 of the year the taxes are due. Under the current system, classified vehicles are taxed on a revolving, year-round schedule. Every month, the Division of Motor Vehicles (DMV) provides each county a list of the motor vehicles in the county for which registration was renewed or obtained two months earlier. The county lists and appraises the vehicles and sends each vehicle owner a bill for the county, city, and special district taxes due. If the owner does not pay the taxes due on a classified, registered vehicle, DMV will refuse to renew the vehicle registration the following year unless the owner obtains a receipt showing that the taxes have been paid.

For classified motor vehicles, the ownership, situs, and taxability of the vehicle are 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. However, the value of the vehicle is determined annually as of January 1 preceding the date the new registration is applied for or the current registration expires. Therefore, property tax bills that taxpayers receive in January through April of each year are based on the value of the vehicles as of January of the preceding year. This means that the property tax assessment can reflect values as old as 16 months. By moving the property tax valuation date to January 1 of the year the taxes are due, the act ties the value of the vehicle closer to its true value in money. The value of a vehicle, like all other tangible personal property, is based upon its true value in money as prescribed by G.S. 105-283.

Stokes County Equalization and Review Board Change. The second part of the act authorizes the Stokes County Board of Equalization and Review to continue meeting after the Board has performed its statutory duties of examining and reviewing the tax lists for the current year and of hearing any request of a taxpayer with respect to the listing or appraisal of property. G.S. 105-322(e) requires a board of equalization and review to complete the above duties by a specified date. The act amended this statute, effective July 22, 1999, to allow the Stokes County Board of Equalization and Review to continue to meet upon completion of these statutory duties in order to carry out the following duties:

- To hear and decide all appeals relating to discovered property.
- To hear and decide all appeals relating to the appraisal, situs, and taxability of classified motor vehicles.
- To hear and decide all appeals relating to audits of property classified at present-use value and to audits of property exempted or excluded from taxation.

AMEND BILL LEE ACT/INCENTIVES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-360	SB 1115	Senator Kerr

AN ACT TO PROVIDE FOR WIDELY SHARED PROSPERITY BY AMENDING THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT, BY PROVIDING ADDITIONAL TAX INCENTIVES FOR VARIOUS BUSINESSES, AND BY MAKING RELATED CHANGES.

OVERVIEW: This act amends the tax laws to expand existing tax incentives for businesses, add new tax incentives and tax reductions for specific businesses, and make related changes. The provisions of the act are listed below, followed by a detailed summary of each provision.

PROVISION	*EFFECTIVE DATE*	*FISCAL IMPACT*
Extend Sunsets on Bill Lee Act Credits.		
Extend sunset on Bill Lee Act from 2002 to 2006, and require Department of Commerce to continue studying impact of Bill Lee Act incentives.	8/4/99	The extension of the sunset will result in a loss of revenue to the General Fund of approximately $13.1 million in the 2002-2003 fiscal year; the loss is expected to increase to as much as $38.1 million by fiscal year 2005-2006.
Incentives for Interstate Passenger Air Carrier Hubs.		
Add passenger air carrier training centers to Bill Lee Act credits.	1/1/99	This change will have an insignificant impact on General Fund revenues.
Allow an interstate passenger air carrier a sales tax exemption for aircraft parts and accessories purchased for use at its hub in this State.	5/1/99	This change will reduce General Fund revenues by approximately $1.2 million a year. It will also reduce local sales

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
		tax revenues.
Reduce sales tax from 6% to 1% with an $80 cap for flight crew training aircraft simulators purchased by an interstate passenger air carrier for use at its hub in this State.	5/1/99	This change will reduce General Fund revenues by approximately $400,000 a year. It will also reduce local sales tax revenues.
Incentives for Non-Profit Insurance Companies.		
Allow certain nonprofit insurance companies an eight-year sales tax refund for taxes paid on building materials and fixtures, and a four-year sales tax refund for taxes paid on capitalized computer equipment.	5/1/99	These changes will reduce General Fund revenues by approximately $600,000 in fiscal year 2000-2001, $1.2 million in fiscal years 2001-2002 and 2002-2003, and by approximately $100,000 in fiscal year 2003-2004.
Incentives for Tiers One and Two.		
Extend Bill Lee Act credits to electronic mail order houses that create at least 250 jobs in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $2.7 million beginning in fiscal year 2001-2002; the loss in revenues is expected to grow to $5.8 million in fiscal year 2004-2005 and decline slightly in fiscal year 2005-2006 to approximately $4.4 million.
Extend Bill Lee Act credits to customer service centers in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $600,000 a year in fiscal year 2001-2002; the loss in revenues is expected

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
		to grow to an annual loss of $2.4 million by fiscal year 2005-2006.
Allow annual refund of 6% sales taxes paid on capitalized machinery and equipment sold to businesses eligible for Bill Lee Act credits and located in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $100,000 a year beginning in fiscal year 2000-2001. The annual loss is expected to increase to $1 million by fiscal year 2005-2006.
Incentives for Small Counties.		
Give a more favorable tier designation to small counties.	1/1/00	This change is expected to have an insignificant impact on General Fund revenues.
Close Development Zone Loopholes.		
Close loopholes in definition of development zones.	8/1/99	This change is expected to increase General Fund revenues by $100,000 a year in fiscal years 2000-2001 and 2001-2002, by $600,000 a year in fiscal year 2002-2003, and by $300,000 a year in fiscal year 2003-2004.
Credit for Development Zone Projects.		
Allow a 25% credit for contributions to nonprofits for capital projects within development zones.	1/1/00	This change is expected to reduce General Fund revenues by $2.5 million in fiscal year 2001-2002 and by $4 million for each year thereafter.

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
Affordable Housing Tax Credit.		
Allow a credit for rehabilitating or constructing affordable housing, effective for new projects.	Beginning: 1/1/00 Sunset: 1/1/06	This change is expected to reduce General Fund revenues by $1.5 million a year in fiscal year 2001-2002, and by as much as $10.1 million a year by fiscal year 2005-2006.
Extend Bill Lee Act Credits to Insurance Company Administrative Offices.		
Allow all Bill Lee Act credits to be taken against insurance premiums tax.	1/1/99	This change is not expected to significantly affect General Fund revenues.
Quality Jobs Assurance.		
Require businesses to provide health insurance and meet environmental, safety, and health standards in order to qualify for Bill Lee Act credits.	1/1/00	This change is not expected to significantly affect General Fund revenues.
Application Fee and Information Changes.		
Eliminate the $75 application fee for Bill Lee Act credits in tiers one and two and increase the fee to $500 per credit in other tiers, with a cap of $1,500 per applicant.	9/4/99	This change is not expected to significantly affect General Fund revenues.
Require applicants for Bill Lee Act credits to provide additional information to enable Commerce to evaluate the effectiveness of the credits in providing employment to residents of development zones.	9/4/99	N/A
Require taxpayers to include with their tax returns the information that they must generate under current law to establish eligibility for the Bill Lee Act credits.	1/1/00	N/A
Clarify Business Definitions and Refunds.		
Clarify definitions of industries covered by Bill Lee Act, effective	8/4/99	N/A

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
immediately		
Clarify sales tax refunds for sales of fuel to interstate air carriers.	10/1/99	N/A
Research and Development Credit.		
Provide that research and development credit will not expire when the corresponding federal credit expires.	1/1/99	This change is not expected to significantly impact General Fund revenues.

Industrial Development Fund/Environmental Certification.		
Require projects to obtain an environmental certification in order to qualify for funding from the Industrial Development Fund (Building Renovation Fund), effective when the act becomes law.	8/4/99	N/A
Dept. of Commerce to Oversee Interstate Cooperative Efforts.		
Require the Department of Commerce to support reasonable efforts to reduce interstate competition in luring businesses from one state to another.	8/4/99	N/A
Brownfields Property Fee Changes.		
Increase fees paid to the Department of Environment, Health, and Natural Resources for brownfields agreements applied for after the act becomes law.	8/4/99	This change is not expected to significantly impact General Fund revenues.

FISCAL IMPACT: *See chart above.*

EFFECTIVE DATE: *See chart above.*

BACKGROUND & ANALYSIS:

Extend Sunset on Bill Lee Act Credits. The William S. Lee Quality Jobs and Business Expansion Act was enacted in 1996, effective beginning with the 1996 tax year, with a sunset effective in 2002. The Act required the Department of Commerce to report annually on the credits allowed by the Act. In 1997, the General Assembly added specific issues that the Department of Commerce was

required to study and report back on in 1999. Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the William S. Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. This act extends the 2002 sunset for an additional four years, to 2006, and it renews the requirement that the Department of Commerce study the effect and effectiveness of the Bill Lee Act incentives and report the results of its study to the 2001 General Assembly.

Incentives for Interstate Passenger Air Carrier Hubs. The act provides three incentives for interstate passenger air carriers with hubs in this State. A hub is defined as the airport where the carrier has allocated at least 60% of its aircraft property tax value and at which the majority of its boarding passengers are connecting from other airports, not originating at that airport. U.S. Airways, whose hub is in Charlotte, qualifies for the credit. Midway Airlines, whose hub is at Raleigh-Durham, should qualify for the credit by the end of 1999.
The first incentive for passenger air carriers is to provide that the Bill Lee Act definition of central administrative offices includes centralized training offices at an air carrier's hub, effective beginning with the 1999 tax year. This change allows the air carrier to qualify for the central administrative office credit, described below, as well as for the existing Bill Lee Act credit for creating jobs, credit for investing in machinery and equipment, credit for research and development, and credit for worker training. These credits can be taken with respect to the training center only.

The central administrative office credit is allowed to taxpayers that purchase or lease real property to be used as central administrative office property with 40 or more employees. The amount of the credit is equal to 7% of the eligible investment amount and may not exceed $500,000. The credit is taken in seven equal installments over the seven years following the taxable year in which the property is first used as a central administrative office.

The second incentive for passenger air carriers is a sales tax exemption for the carrier's purchases of aircraft lubricants, parts, and accessories for use at its hub, effective beginning May 1, 1999. These purchases would otherwise be subject to sales tax at 6%, but interstate air carriers are allowed a partial refund of the tax under G.S. 105-164.14(a). In 1998, the General Assembly enacted a similar exemption for air couriers (Federal Express), effective January 1, 2001.

The third incentive for passenger air carriers is a sales tax reduction from 6% to 1% with an
$80 cap, for purchases of aircraft simulators for flight crew training for use at the hub, effective beginning May 1, 1999. The tax reduction would also apply to interstate air couriers. U.S. Airways plans to establish a flight crew training center at its Charlotte hub, where it would use aircraft simulators.

Incentive for Nonprofit Insurance Companies. The act provides a sales tax refund to certain nonprofit insurance companies for State and local taxes they pay on building materials, supplies, fixtures, and equipment that become a part of their real property and on capitalized computer systems hardware and software. The refund is effective beginning with taxes paid on May 1, 1999. The computer equipment refund expires for taxes paid on or after January 1, 2004, and the building materials refund expires for taxes paid on or after January 1, 2008. To qualify for these refunds, the insurance company must be operated for the exclusive purpose of providing insurance products to nonprofit charitable organizations and their employees. In addition, the Secretary of Commerce must have certified that the insurance company will invest at least $20 million in this State. TIAA, which has announced plans to build an office in Mecklenburg County, fits this description.[8] If TIAA fails to make the $20 million investment within five years after it first receives a refund, it forfeits all refunds it received as a result of this incentive.

Incentives for Enterprise Tiers One and Two. The act provides three incentives for development in enterprise tier one and two counties, which are the counties considered most in need of economic development based on high unemployment, low per capita income, and low population growth.[9] The first incentive extends all of the Bill Lee Act credits to electronic mail order houses that create at least 250 jobs located in an enterprise tier one or two county. The second incentive extends all of the Bill Lee Act credits to certain customer service centers located in an enterprise tier one or two county. An eligible customer service center is a subdivision of a telecommunications or financial services company that provides support services to the company's customers by telephone to support the company's products and services. To qualify, at least 60% of the center's calls must be incoming. This requirement will prevent telemarketing operations from qualifying. The credits allowed under the Bill Lee Act, which this act extends to these electronic mail order houses and customer service centers effective January 1, 2000, are the credit for creating jobs, the credit

[8] There may be one or more other nonprofit insurance companies that could qualify, but only if they make a $20 million investment.

[9] The following 13 counties are in tier one for 1999: Bertie, Edgecombe, Graham, Halifax, Hertford, Hyde, Martin, Northampton, Richmond, Swain, Tyrrell, Warren, and Washington. The following 15 counties are in tier two for 1999: Alleghany, Anson, Ashe, Beaufort, Cherokee, Columbus, Mitchell, Montgomery, Onslow, Perquimans, Robeson, Rutherford, Scotland, Vance, and Yancey.

for investing in machinery and equipment, the credit for research and development, the credit for worker training, and the credit for investing in central administrative office property.

The third incentive allows an annual sales tax refund on taxes paid at 6% (6.5% in Mecklenburg County) on capitalized machinery and equipment sold to a taxpayer engaged in one of the businesses eligible for Bill Lee Act credits, for use in an enterprise tier one or two county. This provision will become effective for taxes paid on or after January 1, 2000. In addition to tier one and two customer service centers and electronic mail order houses discussed above, the following businesses are eligible for Bill Lee Act credits: air courier services, central administrative offices (with at least 40 new jobs), data processing, manufacturing, warehousing, and wholesale trade.

Incentives for Small Counties. The act allows certain counties to qualify for a lower enterprise tier designation, effective January 1, 2000. Under the Bill Lee Act, all counties are divided into five enterprise tiers, ranked by economic distress as measured by a formula that combines unemployment, per capita income, and population growth. Those counties in lower-numbered tiers receive more favorable incentives than those in higher tiers.

First, this act changes the rules for assigning enterprise tier designations to provide that the tier number that would otherwise be assigned by the formula is reduced by one for counties that have a population of less than 50,000 and also have more than 18% of their residents below the federal poverty level. Under this provision, Alleghany, Ashe, Beaufort, Cherokee, Perquimans, Scotland, Vance, and Yancey Counties would move from tier two to tier one; Bladen, Hoke, Jones, Madison, Pamlico, and Pasquotank Counties would move from tier three to tier two; and Duplin, Greene, and Watauga Counties would move from tier four to tier three. Second, the act provides that a county that has a population of less than 25,000 cannot be designated higher than tier three. Under this provision, Polk and Currituck Counties would move from tier five to tier three. Third, the act provides that a county is designated as tier one if it has a population of less than 10,000 and also has more than 16% of its residents below the federal poverty level. Under this provision, Camden, Clay, and Jones Counties would become tier one counties.

Close Development Zone Loopholes. In 1998, the General Assembly amended the Bill Lee Act to provide additional incentives for businesses that locate or expand in development zones, which are economically distressed areas located within cities. The statutory conditions for qualifying as a development zone were designed to target only these relatively small, economically distressed areas. The statutory conditions contained loopholes, however, that allowed large

areas outside of cities to qualify, even if they were not economically distressed throughout. The act closes those loopholes, effective for development zone designations made on or after January 1, 2000.

The 1998 legislation defined a development zone as an area that meets all of the following conditions: (1) consists of one or more contiguous census tracts, block groups, or both, (2) has a population of 1,000 or more, at least 20% of whom are below the poverty level, and (3) is located at least partly in a city with a population over 5,000. This act closes the loopholes in this definition by requiring that:

- Every census tract and census block group in the zone must be located in whole or in part within the primary corporate limits of the city.
- Every census tract and census block group in the zone must have more than 10% of its population below the poverty level, or must be immediately adjacent to a tract or group that has more than 20% of its population below the poverty level.
- None of the census tracts or census block groups may be located in another development zone.

The act also shortens the period during which designation as a development zone is effective, from four years to two years, and requires zone applicants to notify every city in which part of the proposed zone would be located.

The following enhanced incentives apply in development zones: If a business locates in a development zone, the wage standard it has to meet is the same as for tier one counties -- slightly lower than the standard for other counties. In addition, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and there is no threshold for the credit for investing in machinery and equipment.

Credit for Development Zone Projects. The act creates a new tax credit for taxpayers that contribute cash or property to certain nonprofit agencies to be used for an improvement project in a development zone. An improvement project is a project to construct or improve real property for community development purposes or to acquire real property and convert it for community development purposes. The new credit becomes effective beginning with the 2000 tax year.

The credit allowed is 25% of the amount contributed by the taxpayer. The total amount of credits that may be allowed in a taxable year is capped at $4 million. Taxpayers are required to apply to the Secretary of Revenue for these credits. If

the total amount applied for in a year exceeds $4 million, the Secretary will reduce each applicant's credit proportionally.

The credit is allowed for contributions to a development zone agency, defined as a community action agency, a community-based development organization, a community development corporation, a community development financial institution, a community housing development organization, or a local housing authority. To qualify for the credit, all of the following conditions must be met:

- The agency must contract in writing to use the contribution for an improvement project in a development zone and to repay the taxpayer with interest if the contribution is not so used.
- The Department of Commerce must certify that the agency will undertake an improvement project in a development zone.[10] To support this certification, the agency must provide the Department documentation establishing the identity of the agency, the nature of the project, and that the project is for a community development purpose in a development zone.
- The taxpayer must be unrelated to the agency and must not control, be controlled by, or be under common control with the agency.
- The taxpayer must not receive anything of value for the contribution.

A taxpayer forfeits the tax credit for a contribution to the extent the development zone agency uses the contribution for anything other than an improvement project in a zone. Development zone agencies are required to file with the Department of Commerce annual, audited financial statements. If the Department of Commerce finds that any part of a contribution was used for a purpose other than an improvement project, it must notify the Department of Revenue of the resulting forfeiture.

Affordable Housing Tax Credit. The act creates a new tax credit for rehabilitating or constructing low-income housing, effective for buildings allocated federal credits on or after January 1, 2000. The credit expires for buildings allocated federal credits on or after January 1, 2006. The credit is equal to a percentage of the amount of the taxpayer's federal credit for low-income housing with respect to eligible North Carolina low-income housing. The credit is 75% for buildings located in tier one or two and 25% for buildings located in other tiers. North Carolina low-income housing is eligible if it meets one of the following conditions:

- It is located in a tier one or two enterprise area.

[10] The Secretary of Commerce may not certify a development zone agency if it, any of its officers or directors, or any partner of the agency has ever used part of an improvement project contribution for any purpose other than the improvement project.

- It is located in a tier three or four enterprise area and has at least 40% of its residential units that are rent-restricted and are occupied by individuals whose income is 50% or less of area median gross income.
- It is located in a tier five enterprise area and has at least 40% of its residential units that are rent-restricted and are occupied by individuals whose income is 35% or less of area median gross income.

The credit is not taken in one year but is spread out over five years beginning when the federal credit is first claimed for the building. The federal credit is first claimed either when the building is placed in service, or the next year, at the taxpayer's election. The federal credit is taken over eleven years.

The federal credit requires that either (1) at least 20% of the residential units are rent-restricted and occupied by individuals whose income is 50% or less of area median gross income or (2) at least 40% of the residential units are rent-restricted and occupied by individuals whose income is 60% or less of area gross income. By providing a higher credit for tier one and two projects and by limiting the State credit to projects that are either in tier one or two or serve lower-income residents, the act is designed to steer investments toward these projects.

The federal credit requires that the low-income housing be used for that purpose for at least 30 years. If this requirement is not met, all or part of the taxpayer's credit is recaptured. Under the State credit, if federal recapture is required, the taxpayer forfeits the North Carolina credit to the same extent. In addition, if the taxpayer no longer qualifies for the federal credit during one of the five years a State installment could otherwise be claimed, the taxpayer is no longer eligible for the State credit. This situation could occur if the taxpayer sold its interest in the low-income housing.

Under federal law, a limited amount of credit is allowed to each state each year, and these credits are allocated among applicants based on selection criteria designed to reward projects that will serve the lowest income tenants for the longest periods. At least 10% of the credits each year must be set aside for projects sponsored by nonprofits. The amount of federal credit allocated to North Carolina will be $9.2 million for the 2000 through 2002 tax years and is expected to increase to $13 million for the 2003 and 2004 tax years. By limiting the State credit to a percentage of the federal credit, the act automatically caps the potential revenue loss to the State.

Extend Bill Lee Act Credits to Insurance Company Administrative Offices. The act allows all the Bill Lee Act credits to be taken against gross premiums tax, effective beginning in the 1999 tax year. Currently, only the real property credit for central administrative offices may be taken against gross premiums tax.

In 1997, the General Assembly extended the Bill Lee Act credits to central administrative offices that created at least 40 new jobs and created a new tax credit for taxpayers that purchase or lease real property to be used as central administrative office property. In 1998, the General Assembly allowed the real property credit for central administrative offices to be taken against the gross premiums tax as well as against the income tax and the corporate franchise tax. Insurance companies pay gross premiums tax in lieu of income tax. The 1998 legislation did not change the rule that the other Bill Lee Act credits could be taken against only income tax and corporate franchise tax. The 1998 change created a situation in which insurance companies were treated differently from other businesses with respect to central administrative offices. A business, other than an insurance company, that builds a central administrative office can take against income tax not only the real property credit for that office, but also the jobs credit, the investment tax credit, and the worker training credit. An insurance company can take against gross premiums tax only the real property credit, but not the jobs credit, the investment tax credit, or the worker training credit. By extending the other Bill Lee Act credits to gross premiums tax, the act provides uniform treatment for insurance companies and other businesses that build central administrative offices.

Quality Jobs Assurance. The purpose of the original William S. Lee Act was to provide incentives for "high quality jobs." Accordingly, only certain industries qualify for the Bill Lee Act credits and a taxpayer must meet a wage standard with respect to the jobs at the locations for which it claims a credit. This act adds three additional standards to assure that credits are allowed only with respect to high quality jobs. These standards become effective for new credits beginning January 1, 2000. First, the taxpayer must pay at least 50% of basic health insurance coverage for the full-time positions for which it takes a credit. Second, the taxpayer must certify that the business location with respect to which it claims a credit has not had a significant environmental violation in the last five years and has no pending enforcement actions for significant environmental violations. Third, the taxpayer must certify that the business location with respect to which it claims a credit has no outstanding or unresolved OSHA citations and has had no serious violation within the last three years. The Department of Environment and Natural Resources and the Department of Labor are authorized to audit the environmental and OSHA certifications, respectively, and report to the Department of Revenue if they determine that a certification was inaccurate.

Application, Fee, and Information Changes. A taxpayer that wishes to claim a Bill Lee Act credit must apply to the Department of Commerce for certification that it meets the eligibility requirements for the credit. The application must

include information to enable the Department of Commerce to determine the applicant's eligibility, and be accompanied by a $75 fee to defray part of the costs of administering the program. This act requires applicants to include information necessary to enable the Department of Commerce to provide data required in its periodic reports to the General Assembly. This data will assist the General Assembly in evaluating the cost effectiveness of the Bill Lee Act credits.

The act also eliminates the $75 fee for credits claimed with respect to enterprise tier one and two counties. For other credits, the fee is increased to $500 per credit claimed, not to exceed $1,500 per taxpayer. The Department of Commerce will retain ¼ of the fee proceeds for the costs of administering the program, and remit the remaining proceeds to the Department of Revenue for its use in administering and auditing the Bill Lee Act credits. These changes became effective September 4, 1999.

The Bill Lee Act incentives recommended by the Department of Commerce over the last four years have contained many conditions and standards a taxpayer must meet in order to be eligible for the incentives. The incentives also contain what are known as "clawback" provisions, which require a taxpayer to forfeit a targeted incentive if it turns out the taxpayer did not meet the conditions for qualifying for the incentive, and to lose future installments of a tax credit if the job or investment on which the credit was based does not remain in place. This act requires taxpayers that claim Bill Lee Act credits to include with their tax returns information about whether the jobs and investments have remained in place and whether other conditions have been met. The act allows the Department of Revenue to share this information with the Employment Security Commission and the Department of Commerce; this sharing should enable the Department of Commerce to evaluate whether the incentives are accomplishing their purpose of creating high-quality jobs throughout the State.

Clarify Business Definitions and Refunds. The act clarifies the statutory definitions of the types of businesses that are eligible for the Bill Lee Act credits. In 1998, the General Assembly changed the statutory references from the Standard Industrial Classifications (SIC) to the North American Industrial Classification System (NAICS) to conform to the federal system adopted effective January 1, 1999. This system is used to classify most of the data available about industries or kinds of business in the economy. Upon review of the NAICS system, it was discovered that further terminology changes were needed to the Bill Lee Act definitions to assure that the credits would be available to the types of businesses covered by the prior law's definitions.

The act clarifies that interstate air carriers are allowed a partial refund of sales taxes paid on fuel, effective October 1, 1999. This clarification will not change the way the law is currently administered.

Research and Development Credit. The act modifies the research and development credit so that it will not automatically expire if the corresponding federal credit expires. The credit for research and development is allowed only to taxpayers that claim one of the federal research and development credits. In past years, the federal credit has expired and then been renewed retroactively, creating uncertainty for taxpayers. This act amends the State credit so that it is based on the federal credit as of January 1, 1999. Expiration of the federal credit will not affect the State credit. If the federal credit is later modified, the General Assembly can consider whether to update its cross-reference to adopt the federal modifications.

Industrial Development Fund Environmental Certification. The act requires, as a condition for funding from the Industrial Development Fund (Building Renovation Fund), that a project receives certification from the Department of Environment and Natural Resources that it will not have a significant adverse effect on the environment. This change became effective when the act became law, August 4, 1999.

Commerce to Pursue Interstate Cooperative Efforts. The act requires the Department of Commerce to encourage reasonable interstate agreements and federal legislation to control the use of excessive incentives in interstate competition in luring businesses from one state to another. The Department is to report on these efforts by March 1, 2000, and March 1, 2001.

Brownfields Property Fee Changes. Lastly, the act makes changes related to the fees collected by the Department of Environment and Natural Resources in connection with brownfields agreements, effective when the act becomes law, August 4, 1999. These changes increase the application fee from $1,000 to $2,000, and increase the agreement fee from $500 to the actual cost to the State of all activities relating to the brownfields agreement. The $2,000 application fee is a credit against the agreement fee. These sections provide that interest on fees accrues to the Department's Brownfields Account rather than to the General Fund, that unpaid fees are a lien on all of the developer's property as well as on the brownfields property, and that the Department may contract for services necessary to implement the brownfields property law.

Brownfields property is abandoned, idle, or underused property at which expansion or redevelopment is hindered by actual or possible environmental contamination and that is or may be subject to cleanup requirements under State

or federal law. Under current law, the Department of Environment and Natural Resources can enter into a brownfields agreement with the owner of brownfields property, under which the owner is allowed to clean up the property to a level that will allow the property to be used for specified purposes but would not meet current cleanup standards. The owner agrees to clean up the property as specified in the agreement and to limit future uses of the property to those specified in the agreement, i.e., uses that are safe given the less than complete cleanup of the property. This agreement benefits the State by causing a contaminated property to be at least partially cleaned up and put to productive use in place of having a "greenfield" pristine site developed. Under the agreement, the owner is relieved of liability for further cleanup of the property.

MODIFY HISTORIC REHABILITATION CREDIT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-389	SB 251	Senator Horton

AN ACT TO ALLOW THE HISTORIC REHABILITATION TAX CREDIT TO BE ALLOCATED BY A PASS-THROUGH ENTITY TO ITS OWNERS AND TO REQUIRE CORPORATIONS THAT ARE REQUIRED TO PAY FEDERAL-ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER TO PAY STATE-ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER.

OVERVIEW: This act modifies the tax credit for rehabilitating income-producing historic property and it requires corporations that are required to pay federal income tax estimated payments by electronic funds transfer (ETF) to pay State income tax estimated payments by ETF. The Revenue Laws Study Committee recommended the latter change in House Bill 62, introduced by Rep. Gray. The House Finance Committee added the provisions of House Bill 62 to this act.

FISCAL IMPACT:

- Historic Rehabilitation Tax Credit: The fiscal impact of the tax credit changes is unclear.
- Corp. Income Tax Payable by EFT: The Department of Revenue estimates an annual gain of $334,662 to the General Fund from the EFT requirement.

EFFECTIVE DATE:

- Historic Rehabilitation Tax Credit: The changes to the tax credit for rehabilitating income-producing historic property are effective for taxable years beginning on or after January 1, 1999.

- Corp. Income Tax Payable by EFT: The requirement for corporations to pay State income tax estimated payments by EFT becomes effective for taxable years beginning on or after January 1, 2000.

BACKGROUND & ANALYSIS:

Historic Rehabilitation Tax Credit. This act modifies the tax credit for rehabilitating income-producing historic property in two substantive ways and one technical way:

- It allows a pass-through entity, such as a Subchapter S corporation, to allocate the credit among any of the entity's owners, as long as the amount of credit allocated does not exceed the owner's adjusted basis in the pass-through entity. The credit amount may be allocated among any of the pass-through entity's owners, in the entity's discretion. The allocation provision sunsets in three years. Under prior law, the credits were allocated in the same proportion as other income items allocated to the owners under the Code.
- It adds provisions to recapture the credit if the taxpayer is required to recapture the credit under the Code or if a partner or owner disposes of its interest in the pass-through entity.
- It consolidates the credits for rehabilitating an historic property into one tax Article. The credits are currently duplicated in two separate statutes in the individual and corporate parts of the income tax Article in Chapter 105.

Taxpayers are allowed an income tax credit of 20% of the expenses of rehabilitating an income-producing historic structure and a credit of 30% of the expenses of rehabilitating an historic structure that is not income-producing. The credit for income-producing structures is lower because federal law also allows a 20% credit for those expenses, yielding a combined credit of 40%. The 20% credit is allowed only if the taxpayer qualifies for the federal credit and the 30% credit is allowed only if the taxpayer does not qualify for the federal credit. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

A pass-through entity may qualify for the rehabilitation credits and pass the credits on to its owners. A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns.

Under the Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership agreement must have a substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. Therefore, the allocation agreement of partners cannot give one partner 100% of the income, loss, or credits of the partnership. Under prior North Carolina law, the pass-through entity was required to allocate a tax credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, were allocated under the Code. This meant that if foreign investors were involved in a qualifying rehabilitation project, their tax credits could not be redistributed to North Carolina investors with State income tax liability.

In putting together an investment group for an income-producing historic rehabilitation project, the project sponsors may find some investors that can benefit from only the federal credit, because they have little or no North Carolina tax liability, and other investors that can benefit from both the federal and the North Carolina credit because they have both types of tax liability. This act changes the allocation of the credit to allow the maximum tax credit available for each of the project investors. It allows a pass-through entity to allocate the credit for rehabilitating an income-producing historic structure among any of its owners, as long as the amount of the allocated credit does not exceed the owner's adjusted basis in the entity, as determined under the Code. The adjusted basis is determined at the end of the taxable year in which the historic structure is placed in service. Each year an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return that shows both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 and G.S. 105-269.15. G.S. 105-131.8 provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-269.15 provides that the tax credit allowed a partner is based on the partnership agreement, which must have substantial economic effect.

The act also requires forfeiture of all or part of the credit for an income-producing historic structure when the following occurs:

- Forfeiture for Disposition. -- When a taxpayer is required by the Code to recapture part or all of the federal credit, then the taxpayer must forfeit the corresponding part of the State credit. Under the Code, the recapture does not apply if the property is disposed of because of the death of the taxpayer, a mere change in form of doing business, or a transfer between spouses or incident to a divorce

- Forfeiture for Change in Ownership. -- If an owner of a pass-through entity that qualified for the credit disposes of all or a portion of the owner's interest in the pass-through entity within five years after the date the structure was placed in service so that the owner's interest is reduced to less than 2/3 of its interest at the time the structure was placed in service, the owner must forfeit a portion of the credit. This recapture does not apply if the change in ownership is due to the death of the owner or to a merger or consolidation requiring approval of the members of the taxpayer pass-through entity to the extent the entity does not receive cash or property.

If a taxpayer or owner of a pass-through entity forfeits the credit, then the taxpayer or owner is liable for all past taxes avoided plus interest. The past taxes and interest are due 30 days after the credit is forfeited.

Electronic Funds Transfer. The act requires corporations that are required to pay federal income tax estimated payments by EFT to pay State income tax estimated payments by EFT, effective for taxable years beginning on or after January 1, 2000. This change in the law will eliminate thousands of returns, not payments, each year. It will enable the State to receive tax payments more quickly and thus gain three to five days of interest on the payments.

In 1993, the General Assembly authorized the Department of Revenue to collect taxes by EFT. The average tax payment must be at least $20,000 a month before the tax payment must be submitted by EFT. The $20,000 threshold applies separately to each tax. This act creates a different rule for corporate estimated income tax payments in order to increase the efficiency of State tax collections and to conform the State's method of collecting corporate estimated income tax payments with federal law so that a taxpayer has only one set of rules to learn and follow. For federal purposes, a corporation whose depository taxes exceed $200,000 in a twelve-month period must pay its corporate income tax estimated payments by EFT. The federal regulations list the different types of depository taxes. Examples of depository taxes include social security taxes, withheld income taxes, and corporate estimated income taxes. The Internal Revenue Service raised the threshold from $50,000 to $200,000 in July 1999. The higher threshold will limit the EFT requirement to the largest 9% of taxpayers, but other taxpayers are expected to use EFT voluntarily.

1999 FEE BILL

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-413	HB 289	Representative Luebke

AN ACT TO SET THE PUBLIC UTILITY REGULATORY FEES, TO SET THE INSURANCE REGULATORY CHARGE, TO IMPOSE THE INSURANCE REGULATORY CHARGE ON SERVICE CORPORATIONS AND ON HEALTH MAINTENANCE ORGANIZATIONS IN THE YEAR 2000, TO ALLOW THE DEPARTMENT OF AGRICULTURE AND CONSUMER SERVICES TO IMPOSE FEES THAT REFLECT THE ACTUAL COST OF RENDERING THE SERVICE, AND TO LIMIT THE FEE THAT AN APPLICANT MUST PAY FOR A WATER QUALITY CERTIFICATION THAT IS REQUIRED FOR A PERMIT UNDER THE COASTAL AREA MANAGEMENT ACT OF 1974.

OVERVIEW: This act makes three tax law changes and two fee changes; only the tax law changes are summarized here. This act sets the tax rates for the public utility regulatory fee for the 1999-2000 tax year and for the insurance regulatory fee for the 1999 calendar year. The act also expands the scope of the insurance regulatory fee to include health maintenance organizations and medical service corporations, effective beginning in the 2000 calendar year.

FISCAL IMPACT:

- Public Utility Regulatory Fee: This fee is expected to generate $8.5 million.
- NC Electric M'ship Corp.: This fee is expected to generate $200,000.
- Insurance Regulatory Fee: The fee is set at 7% for the 1999 calendar year (the 1998 rate was 6%). This charge is expected to generate $20.65 million for the 1999-2000 fiscal year (an increase of $1.45 million over the previous year). In addition, effective in 2000, health maintenance organizations (HMO's) and medical services corporations will be required to pay the fee. This requirement will generate between $2.45 million and $2.8 million. *(See Background & Analysis section for more detailed information.*

EFFECTIVE DATE:

- Public Utility Regulatory Fee: 1999-2000 tax year
- NC Electric M'ship Corp.: 1999-2000 tax year
- Insurance Regulatory Fee: 1999-2000 calendar year; effective for HMO's and medical services corporations in 2000.

BACKGROUND & ANALYSIS:

Public Utility Regulatory Fee: The act sets the general rate for the public utility regulatory fee at 0.09% for the 1999-2000 fiscal year. This is the same rate that was in effect for the 1997-1998 fiscal year and is expected to generate $8.5 million. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric rates and service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina.

Secondly, the act sets at $200,000 the special public utility regulatory fee imposed on the North Carolina Electric Membership Corporation, effective for the 1999-2000 fiscal year. The proceeds of the fee will be credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations. The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiaries must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levies a flat-rate regulatory fee to be paid by the North Carolina Electric Membership Corporation. The General Assembly must establish the fee amount each year. The North Carolina Electric Membership Corporation is the only electric membership corporation in North Carolina whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives." Thus, the fee imposed on

the North Carolina Electric Membership Corporation will be passed on to its member electric membership corporations.

Insurance Regulatory Fee: First, the act sets the insurance regulatory charge at 7% for the 1999 calendar year, an increase from the 6% rate in effect for 1998. The charge is expected to generate $20.65 million for the 1999-2000 fiscal year, an increase of $1.45 million over the previous year. The insurance regulatory charge is a tax that was enacted in 1991 to make the Department of Insurance receipt-supported and thereby eliminate General Fund support for the Department. The charge is a percentage of each insurance company's premiums tax liability.

Second, the act imposes the insurance regulatory charge on health maintenance organizations and medical service corporations, effective beginning in 2000. The fee will be levied on each company's hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because medical service corporations pay premiums tax at a rate of 0.5% rather than 1.9% and because health maintenance organizations do not pay premiums tax. Adding health maintenance organizations and medical service corporations to the insurance regulatory charge will increase the base against which the charge is levied by $35 to $40 million. At a regulatory charge rate of 7%, this would generate $2.45 to $2.8 million in proceeds.

Prior to the enactment of this act, the insurance regulatory charge was imposed only on insurance companies that pay the gross premiums tax, other than medical service corporations such as Blue Cross Blue Shield and Delta Dental Corporation, which were exempt. Health maintenance organizations did not pay the regulatory charge because they do not pay the gross premiums tax. Prior to 1995, these entities contributed to the Department of Insurance Fund through insurance audit and examination fees. However, in 1995, the General Assembly eliminated the insurance audit and examination fees for insurance companies, health maintenance organizations, medical corporations, and guaranty associations. The revenue generated by these audit fees was an estimated $4.5 million annually. The costs of the audits are now paid for by the insurance regulatory charge as part of the costs of regulating the insurance industry. This act distributes the responsibility for funding the Department of Insurance among all the entities that it regulates.

PENSION TAX WITHHOLDING

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-414	HB 1466	Representative Cansler

AN ACT TO PROVIDE FOR WITHHOLDING OF NORTH CAROLINA INCOME TAXES FROM TAXABLE PENSIONS, ANNUITIES, AND DEFERRED COMPENSATION.

OVERVIEW: This act requires a person paying pensions, annuities, and deferred compensation to withhold North Carolina individual income tax from the payments unless the recipient elects not to have the tax withheld, effective January 1, 2001. Income that is exempt from tax is exempt from this withholding requirement. Therefore, the act does not apply to retirement income paid to federal, State, and local retirees with five years of creditable service as of August 12, 1989, because this income is exempt from State income tax due to a court decision in the Bailey, Emory, and Patton lawsuits.

FISCAL IMPACT: Unable to determine.

EFFECTIVE DATE: Taxable years beginning on or after January 1, 2001.

BACKGROUND & ANALYSIS: Under federal law, withholding is required on pensions, annuities, and certain deferred income, including IRAs. Prior to this act, North Carolina has not piggybacked this aspect of federal law. This act provides that a pension payer required to withhold federal income tax on a pension payment to a resident of North Carolina must also withhold State income tax. A recipient may elect to not have tax withheld from the pension payment. The pension payer must notify each recipient of the right to elect not to have tax withheld. An individual who elects not to have tax withheld from the pension payment must estimate their income tax liability each year and pay the tax in four installments.

In the case of periodic payments, the pension payer must withhold as if the recipient were a married person with three exemptions, unless the recipient provides an exemption certificate reflecting a different filing status or number of exemptions. For a non-periodic payment, the pension payer must withhold 4% of the payment. A pension payer who fails to withhold or remit the tax that is withheld is liable for the tax.

Currently, the Department of Revenue allows voluntary withholding by employers. The holder of an IRA, although not an employer, may also enter into

a voluntary withholding agreement. However, if the payer withholds the tax but does not pay it to the Department of Revenue, the taxpayer's only recourse is against the payer. The Department cannot credit the taxpayer and pursue the payer. Under this act, effective for taxable years beginning on or after January 1, 2001, the withholding will be mandatory unless the recipient elects not to have the tax withheld.

UPDATE CODE/ CRIMINAL DEADLINE/ RESEARCH

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-415	HB 1476	Representative Miller

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO EARMARK PART OF THE RESULTING REVENUE GAIN FOR TAX RESEARCH, TO DIRECT THE STATE AUDITOR TO CONDUCT A PERFORMANCE AUDIT OF THE DEPARTMENT OF REVENUE, TO CONFORM TO THE FEDERAL STATUTE OF LIMITATIONS FOR WILLFUL FAILURE TO COMPLY WITH STATE TAX LAWS, AND TO INCREASE THE AMOUNT OF TIME A TAXPAYER HAS TO PROTEST THE PAYMENT OF A TAX.

OVERVIEW: This act makes the following changes relating to tax law:

- Update IRC Reference. It rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from September 1, 1998, to June 1, 1999. This change became effective August 5, 1999.
- Conform Criminal Deadline to Federal. It conforms the State statute of limitations, with respect to the willful failure to comply with the State's tax laws, to the federal statute of limitations. This change is effective December 1, 1999, and applies to prosecutions brought on or after the date for cases where the existing statute of limitations had not expired prior to December 1, 1999.
- Extend Protest Period. It increases the amount of time a taxpayer has to protest the payment of a tax from one year to three years. This change is effective for taxes paid on or after January 1, 1999.
- Dept. of Revenue Tax Research Positions. It earmarks part of the revenue generated by this act to pay for four new tax research positions for the Department of Revenue, as recommended by the Revenue Laws Study Committee. This change became effective August 5, 1999.

- Performance Audit. It earmarks part of the revenue generated by this act for a performance audit of the Department of Revenue, to be conducted by the State Auditor, addressing technology issues, internal organization, budgeting and fiscal management, staffing, and other issues. This change became effective August 5, 1999.

FISCAL IMPACT: The Code Update is expected to increase General Fund revenues by $11.55 million in fiscal year 1999-2000, $2.95 million in fiscal year 2000-2001, $1.4 million in fiscal year 2001-2002, $900,000 in fiscal year 2002-2003, and $100,000 in fiscal year 2003-2004.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

Update Code Reference. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. This update generally has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law.

Since the General Assembly updated the State's reference to the Internal Revenue Code to September 1, 1998, Congress has enacted two bills that affect the Code. On October 21, 1998, the President signed into law Public Law 105-277, which includes the Tax and Trade Relief Extension Act of 1998. On April 19, 1999, the President signed into law Public Law 106-21, which extends the tax benefits available with respect to services performed in a combat zone to services performed in the Kosovo area.

Public Law 105-277: This federal law extended the research and development credit, created or extended tax breaks aimed particularly at individuals, small businesses, and farmers, narrowed some tax exemptions, and made many technical changes. The following is a summary of some of the more significant provisions:

- It extends the research and development credit through June 30, 1999. North Carolina's credit for research and development is based upon this federal credit.
- It accelerates the deduction for health insurance costs of self-employed individuals. Self-employed individuals are entitled to deduct a portion of the amount paid for health insurance for the self-employed individual and the individual's spouse and dependents. Under prior law, the amount that could be deducted was being phased up from 45% in 1998 to 100% in 2007. Public Law 105-277 accelerated the amount that could be deducted

to 60% for tax years beginning in 1999 through 2001, to 70% for tax years beginning in 2002, and to 100% for tax years beginning in 2003 and thereafter. This change will treat the self-employed the same as employees, who may exclude from income 100% of employer-provided health insurance.

- It provides a five-year net operating loss carryback for farmers, effective for net operating losses arising in taxable years beginning after December 31, 1997. A net operating loss is the amount by which business deductions exceed business gross income. Generally, a net operating loss may be carried back two years and forward 20 years to offset taxable income in such years. Public Law 105-277 created an exception for farming losses. A farming loss is defined as the amount of any net operating loss attributable to the income and deductions of a farming business.
- It permanently extends the income averaging provision for farmers. An individual engaged in a farming business may elect to compute current year tax liability by averaging, over the prior three-year period, all or a portion of the taxable income that is attributable to the farming business. This provision would have expired for taxable years beginning on or after January 1, 2001.
- It allows a taxpayer that wins a contest, lottery, jackpot, etc., and elects to take the payment as an annuity to claim the prize winnings as income at the time they are received. Prior to the enactment of this law, a person who had the option of receiving either a lump-sum distribution or an annuity was required to include the value of the award in gross income in the year in which the prize was won, even if the annuity option was exercised.
- It permanently extends the charitable market-value deduction for contributions of qualified appreciated stock to private foundations.
- It limits specified liability losses to product liability losses and amounts allowable as a deduction that are in satisfaction of a liability under a federal or state law requiring reclamation of land, decommissioning of a nuclear power plant, dismantlement of a drilling platform, remediation of environmental contamination, or a payment under any workers compensation act. A specified liability loss may be carried back 10 years rather than being limited to the general two-year carryback period. Prior to the enactment of this law, a specified liability loss included other liabilities that arose under federal or state law or out of any tort of the taxpayer.
- It requires certain deductible liquidating distributions of a regulated investment company or real estate investment trust to an 80% corporate owner to be included in the corporation's income.

Public Law 106-21: This federal law extends the tax benefits available under the Internal Revenue Code with respect to services performed in a combat zone to services performed in a "qualified hazardous duty area". The term "qualified hazardous duty area" means any area of the Federal Republic of Yugoslavia, Albania, the Adriatic Sea, and the northern Ionian Sea during the period that any member of the Armed Forces of the United States is entitled to combat pay for services performed in the area.

Under the Code, all or most of military personnel's combat pay is exempt from income tax. Since North Carolina begins its calculation of taxable income with federal taxable income, this pay is also exempt from State income tax. The Code also extends the time military personnel and those serving in support of the military personnel have to file and pay their taxes. Public Law 106-21 extends these provisions to those individuals within the "qualified hazardous duty area" defined above and to those individuals supporting Operation Allied Force who are away from their permanent duty stations.[11] The extension lasts until 180 days after taxpayers leave the defined areas or their supporting operation, plus the number of days they were there during the tax filing season after the air strikes began on March 24, 1999. The tax relief provisions also apply during any period of hospitalization resulting from injuries or illness incurred while serving in the combat zone. During the extension, affected taxpayers will not accrue any interest or penalty charges and the IRS will not pursue any tax enforcement action. G.S. 105-249.2 prohibits the Secretary of Revenue from assessing interest or a penalty against a taxpayer for any period that is disregarded for federal income tax purposes.

Background for Code Update. 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. 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 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 have a substantial impact on revenues. 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.

[11] Operation Allied Force began on March 24, 1999, when U.S. military forces, acting with NATO allies, commenced air strikes against Serbian military targets in the Former Yugoslavia. On June 20, 1999, Operation Allied Force was officially terminated.

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."

In 1997, the Revenue Laws Study Committee explored the possibility of legislation that would automatically adopt federal changes to the Code each year, with legislative review and approval required in the succeeding legislative session. It was hoped that this approach would avoid the practical difficulties that occur when Code changes go into effect many months before the General Assembly has a chance to pass legislation adopting the changes. The Attorney General's Office reviewed the relevant case law in this State and other states before concluding that this approach would be unlikely to withstand a constitutional challenge.

Conform Criminal Deadline to Federal. Under North Carolina law, it is a Class 1 misdemeanor to willfully fail to collect, withhold, or pay over taxes or to willfully fail to file a return or pay the tax due. Under prior law, the State had three years from the date of the violation to prosecute the taxpayer that violated the tax law. Under federal law, the IRS has six years from the date of the prosecution to pursue the violation. Sections 2 and 3 of this act conform the State statute of limitations to the federal statute of limitations by extending the time the State has to pursue a violation of the tax laws from three years to six years. This change is effective December 1, 1999, for cases where the three-year statute of limitations has not already expired.

Extend Protest Period. The act extends the time a taxpayer has to challenge the unconstitutionality of most taxes from one year to three years, effective for taxes paid on or after January 1, 1999. 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 after paying the tax. This procedure is known as "paying under protest".

Tax Research Positions. Upon recommendation of the Revenue Laws Study Committee, the act authorizes the Secretary of Revenue to draw funds from the revenues generated by updating the Internal Revenue Code reference to fund four tax research positions in the Department of Revenue, effective January 1, 2000. The Revenue Laws Study Committee determined that there is a need for in-depth tax research that cannot be met by the current three-person staff. Adding four new tax analyst positions would provide a tax research resource capable of serving the needs of the legislative and executive branches for analyses of various tax proposals and of the effect of changes in the economy on the tax base.

Performance Audit. The act directs the Office of the State Auditor to conduct a performance audit of the Department of Revenue, addressing the following areas: (i) tax collection and tax auditing activity, with particular attention to the cost, efficiency, and effectiveness of the Integrated Tax Administration System and subsequent automation projects; (ii) current methods of processing tax returns and payments and the ability to employ the latest technology in this processing; (iii) internal organization and management; (iv) budgeting and fiscal management; (v) current and future staffing requirements; and (vi) any other issues the State Auditor considers necessary or desirable. The State Auditor is to submit an interim progress report to the Senate and House Appropriations Subcommittee on General Government and the General Assembly's Fiscal Research Division by May 30, 2000, and a final report to the General Assembly by January 1, 2001. The Secretary of Revenue is directed to draw $100,000 from funds generated by the act to pay for the performance audit.

NO SALES TAX FEE/OTHER CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-438	SB 1112	Senator Kerr

AN ACT TO PROMOTE ELECTRONIC COMMERCE BY REPEALING THE SALES TAX REGISTRATION FEE AND TO MAKE OTHER CHANGES TO THE TAX LAWS AND RELATED STATUTES.

OVERVIEW: This act makes numerous tax law changes as described below:

- Privilege Tax on Loan Agencies. It reduces the annual privilege tax on loan agencies from $750.00 to $250.00. In addition, the act expands the scope of the tax to include pawnbrokers and check cashers. This change is effective July 1, 1999.

- Repeal Sales Tax Registration Fee. It repeals the one-time $15.00 registration fee retailers and wholesalers must pay when registering with the Department of Revenue for sales and use tax purposes. This change is effective January 1, 2000.
- Repeal Sales Tax on Medical Equipment and Sundries. It exempts durable medical equipment and medical sundries from sales tax. This change is effective October 1, 1999.
- Repeal Sales Tax on Prescription Drugs. It exempts physicians and other medical professionals who buy drugs to administer to their patients, and State hospitals (other than UNC hospitals) from paying sales and use tax on prescription drugs. (Note: other prescription drugs, including prescriptions, drugs purchased by the UNC hospitals, drug samples distributed by the manufacturer, and drugs purchased for use in the commercial production of animals, are either exempt from sales and use tax or the tax is refundable.) This change is effective October 1, 1999.
- Repeal Sales Tax Exemption for Traded-In Items. It repeals the sales tax exemption for certain traded-in items. This change is effective October 1, 1999.
- Repeal Unconstitutional Sales Tax Provisions. It repeals two sales tax provisions that may be unconstitutional: the requirement that a nonprofit corporation must be chartered in North Carolina in order to claim an exemption from collecting sales tax on items sold as a part of an annual fundraiser, and the sales tax exemption for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use in free publications that contained advertising of a general nature. Both changes are effective October 1, 1999.
- Airport Authority Sales Tax Refunds. It entitles all local airport authorities created by the General Assembly to receive sales tax refunds. This change is effective July 1, 1999.
- Tax Penalty and Assessment Changes. It makes several changes to tax penalty and assessment rules, including authorizing the Secretary of Revenue to waive bad check penalties in the same manner as other penalties are waived, and conforming the negligence penalty for large corporate income tax deficiencies with other large tax deficiencies. The tax penalty changes are effective October 1, 1999, and the assessment changes are effective August 10, 1999.
- Special Mobile Equipment Changes. The act allows untaxed diesel fuel to be used in special mobile equipment, effective October 1, 1999, and also allows a quarterly refund for tax paid on any taxed motor fuel used to operate special mobile equipment, effective for taxes paid on or after January 1, 1999. It also increases the registration fee for special mobile equipment from $20.00 to $40.00, effective January 1, 2000. Finally, it

expands the maximum width of special mobile equipment from 96 inches to 102 inches, effective August 10, 1999.

- Miscellaneous Tax Law Changes. The act also makes the following minor tax law changes:
  - Political Parties Financing Fund. Requires that the individual income tax return contain a line authorizing a contribution to the Political Parties Financing Fund, effective August 10, 1999.
  - Definition of a Utility for Sales Tax Purposes. Clarifies the definition of a utility for sales tax purposes, effective August 10, 1999.
  - No Sales or Use Tax/Certain Tangible Personal Property. Provides that sales and use taxes do not apply to tangible personal property that a merchant manufactures or purchases for resale but then withdraws from inventory and donates to a governmental entity, effective October 1, 1999.
  - Increase Restaurant Service Charges Not Subject to Sales Tax. Increases the amount of the service charge that may be added to a restaurant patron's bill without being subject to sales tax, effective October 1, 1999.
  - Information Sharing/DOR and Law Enforcement. Authorizes the Department of Revenue to share information about excise taxes on tobacco, alcohol, and unauthorized substances with law enforcement officials, effective August 10, 1999.
  - Repeal Certain Motor Fuel Tax Licenses. Repeals the requirement that bulk end users and retailers of undyed diesel fuel obtain a motor fuel tax license, and clarifies that a motor fuel supplier is allowed a discount of the tax due only if the tax is paid on time, effective August 10, 1999. Repeals the requirement that a bonded importer of motor fuel was required to obtain an import confirmation number, effective August 10, 1999.
  - DOR Authorized to Use Certain Information. Authorizes the Department of Revenue to use information in the State Directory of New Hires to administer tax collection, effective August 10, 1999.

FISCAL IMPACT: Taken as a whole, the act is expected to increase General Fund revenues by less than $1 million a year the first three years it is in effect and then reduce General Fund revenues by less then $1 million a year the next two years it is in effect.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

Privilege Tax on Loan Agencies. Under prior law, loan agencies were subject to an annual privilege tax of $750. Effective July 1, 1999, Section 2 of this act reduces the tax to $250 a year and expands its scope to apply to pawnbrokers and check cashers. This change is expected to reduce General Fund revenues by less than $300,000 a year. Pawnbrokers and check cashers are engaged in a similar business as loan agencies; the intent of the act is that similar taxpayers should be treated the same. Earlier versions of the bill would have retained the tax at $750, but the tax was reduced in response to complaints from pawnbrokers. The privilege tax statute caps at $100 the local privilege tax that counties and towns may levy on these businesses. Under former law, counties and towns were authorized to levy a local privilege tax of up to $275 on pawnbrokers.

Repeal Sales Tax Registration Fee. Under prior law, retailers and wholesalers were required to pay a fee of $15 when registering with the Department of Revenue for sales and use tax purposes. Registration is a one-time requirement before a merchant can begin a business that is subject to sales or use tax. Sections 1 and 1.1 of this act repeal the $15 fee effective January 1, 2000. Eliminating the fee will enable the Department of Revenue to handle registrations electronically. This change is expected to reduce General Fund revenues by approximately $540,000 a year.

Repeal Sales Tax on Medical Equipment and Sundries. Section 5 of this act exempts from sales tax durable medical equipment and medical sundries that are eligible for coverage under Medicare and Medicaid, effective October 1, 1999. This change is expected to reduce General Fund revenues by approximately $700,000 a year. The new exemption applies only to items purchased on prescription or by a certificate of medical necessity. While the item must be eligible under Medicare or Medicaid, the exemption applies whether or not it is purchased by a beneficiary under those programs. Durable medical equipment includes a variety of medical items such as wheelchairs, IV bag holders, and cane stands. Medical sundries are items that are easily and frequently disposed of, like latex gloves, gauze, medical tape, and syringes.

Repeal Sales Tax on Prescription Drugs. Sections 6 and 7 of this act exempt from sales tax all prescription drugs, effective October 1, 1999. This change is expected to reduce General Fund revenues by approximately $2 million a year. Under prior law, most prescription drugs were already either exempt from State and local sales and use taxes or refundable. The prior exemptions for prescription drugs applied to drugs purchased with a prescription (G.S. 105-164.13(13)), prescription drugs distributed free of charge by the manufacturer of the drugs (G.S. 105-164.13(13b)), and prescription drugs purchased for use in the commercial production of animals (G.S. 105-164.13(2a)). Prescription drugs

distributed free of charge by the manufacturer include samples given to physicians to give to patients and drugs donated to groups such as the American Red Cross.

Most hospitals receive refunds of State and local sales and use taxes paid on prescription drugs they acquire. G.S. 105-164.14(b) allows all nonprofit hospitals, except those operated by the State, and all for-profit hospitals to receive refunds of State and local sales and use taxes paid on prescription drugs. G.S. 105-164.14(c) allows the University of North Carolina Hospitals at Chapel Hill to receive refunds of State and local sales and use taxes paid on prescription drugs acquired for use by the hospital. The State General Fund receives a refund of local sales and use taxes paid by the other State hospitals on prescription drugs. Thus, after combining the exemptions and refunds for prescription drugs, the only entities that were paying tax on prescription drugs were physicians and other medical professionals who buy the drugs to administer to patients in the course of their practice and State hospitals, other than the UNC hospitals. The exemptions and refunds for prescription drugs had evolved over the years in a piecemeal fashion, leaving this small segment subject to the taxes.

In addition to the UNC hospitals, the State operates four psychiatric hospitals: Dorothea Dix Hospital, Broughton Hospital, Cherry Hospital, and John Umstead Hospital. The State also operates various Alcohol and Drug Treatment Centers and Mental Retardation Centers around the State. These centers are in-patient facilities similar to hospitals. State agencies generally do not receive a refund of State sales and use taxes. These agencies receive an appropriation from the State that includes the amount needed to pay sales and use taxes.

Repeal Sales Tax Exemption for Traded-in Items. Section 8 of this act simplifies the sales tax treatment of traded-in items by repealing the exemption for certain traded-in items, effective October 1, 1999. This change is expected to increase General Fund revenues by approximately $1.2 million a year. Under prior law, if a used item were traded-in on the purchase of a new item, the used item would not be subject to sales tax when it was resold if the person who traded it in paid the full amount of sales tax on the new item purchased. This law created problems for retailers who were required to retain the tax records on the new item with the used item to determine the sales tax treatment of the used item when it was resold. If the items in question were subject to a reduced tax rate, as farm equipment is, then upon resale the traded-in item would be subject to local but not State sales tax, an added complication for retailers. Under this section, traded-in items will be subject to full State and local sales tax, as other used items are.

Repeal Unconstitutional Sales Tax Provisions. Sections 9 and 10 of this act address two sales tax provisions that are probably unconstitutional. Under prior law, certain nonprofit corporations were not required to collect sales taxes on items sold as part of an annual fundraiser. To qualify for the exemption, the corporation was required to have been chartered in North Carolina for two years. This classification does not have a rational basis and thus probably violated the uniformity requirements of the constitution. Section 9 of this act repeals the requirement that the corporation be chartered in North Carolina, effective October 1, 1999. This change is expected to have a negligible impact on General Fund revenues.

Prior law granted a sales tax exemption for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use as component parts in free circulation publications that contained advertising of a general nature. The exemption applied to general shoppers guides but not to more specialized guides, such as real estate guides. The first amendment of the United States Constitution does not allow a state to discriminate between publications based on their content. The prior law exemption clearly violated this rule by exempting guides with general content but not those with narrower content. Section 10 of this act repeals the exemption, effective October 1, 1999, so that supplies sold for all free publications will be subject to tax on a uniform basis. This change is expected to increase General Fund revenues by approximately $2.5 million a year.

Airport Authority Sales Tax Refunds. Under prior law, a local airport authority created by local act of the General Assembly was entitled to an annual refund of sales and use taxes it paid if the local act creating it gave it all the rights of a municipality, declared it to be a municipality, or specifically authorized it to receive sales tax refunds. Section 14 of this act expands the refunds to all local airport authorities created by the General Assembly, effective for purchases made on or after July 1, 1999. This change is expected to reduce General Fund revenues by between $4,000 and $18,000 a year.

Under prior law, 24 of the 33 local airport authorities were authorized to receive the sales tax refunds. Each year, local bills would be introduced to grant refunds for additional airport authorities. Two were added in 1999 by S.L. 1999-104. Because there appeared to be no reason to distinguish between those authorities entitled to refunds and those not entitled to refunds, Section 14 provides that all local airport authorities will be treated alike and local bills will no longer be necessary to add airport authorities one by one to the refund provision.

The refunds apply to direct purchases of tangible personal property. They also apply to sales and use tax liability indirectly incurred by a local airport authority

on building materials, supplies, fixtures, and equipment that become a part of any building that is owned or leased by the authority and is being built, altered, or repaired for use by the authority. To obtain a sales and use tax refund, an authority must request the refund in writing within six months after the end of its fiscal year. The request must include any information and documentation required by the Secretary of Revenue.

Tax Penalty and Assessment Changes. Sections 15, 16, 17, and 19 of this act make changes in tax penalties and tax assessment rules. The tax penalty changes are effective October 1, 1999, and the assessment changes are effective August 10, 1999. No estimate is available of the impact these changes will have on General Fund revenues.

Under prior law, the Secretary of Revenue was permitted to waive all tax penalties except the penalty for bad checks. The exception had been made at the request of the Department of Revenue to reduce the administrative burden of having to consider and act on waiver requests with respect to bad checks. Sections 15 and 17 repeal the exception for the bad check penalty, so that all tax penalties will be subject to the same waiver authority. This change is not expected to have a significant impact on General Fund revenues. The penalty for bad checks is 10% of the amount of the check, with a minimum of $1 and a maximum of $1,000.

Under prior law, there were three general categories of negligence penalties: a general negligence penalty of 10% and two large tax deficiency penalties of 25%. The large negligence penalty applied to income tax only if the taxpayer understated taxable income by an amount equal to ¼ or more of gross income. The large negligence penalty applied to other taxes if the taxpayer understated tax liability by ¼ or more. The large deficiency test for income taxes is more forgiving than the stricter large deficiency test for other taxes. Section 16 of this act, requested by the Department of Revenue, limits the more forgiving large deficiency test to individual incomes taxes and moves corporate income taxes to the stricter large deficiency test that applies to other taxes.

The authority of the Department of Revenue to assess taxes and to make refunds of taxes is subject to statutory time limitations. Under prior law, a taxpayer that is under investigation by the Department of Revenue could voluntarily waive the time limit for assessments in order to allow time for the investigation to be completed properly. The time limit for making refunds could not be extended, however. Thus, if the additional investigation to which the taxpayer agreed showed that a refund, rather than an assessment, was appropriate, the refund could not be made. Section 19 of this act, requested by the Department of Revenue, modifies the tax refund time limitations to state that the taxpayer's

extension of the assessment time limits automatically extends the time in which the taxpayer can request a refund.

Special Mobile Equipment Changes. Sections 22, 24, and 27 through 29 of this act make changes related to special mobile equipment. Special mobile equipment is a vehicle that has a permanently attached crane, mill, ditch-digging apparatus, or similar attachment. The vehicle is driven on the highway only to get to and from a non-highway job. It is not designed or used primarily for the transportation of persons or property.

Sections 22, 24, and 27 address a problem relating to motor fuel tax. The motor fuel tax is designed to apply only to fuel used for highway purposes. Motor fuel used for non-highway purposes is instead subject to sales tax. Thus, special mobile equipment should not have to pay motor fuel tax on the fuel it uses for non-highway purposes. However, under prior law, it could not use dyed (untaxed) diesel fuel and was not authorized to receive a refund of motor fuel tax paid on clear (taxed) diesel fuel. Section 22 of this act provides that dyed (untaxed) diesel fuel may be used in special mobile equipment, effective October 1, 1999. Section 24 of this act allows a quarterly refund for tax paid on motor fuel used to operate special mobile equipment off-highway, effective for taxes paid on or after January 1, 1999. As a result of these changes, the motor fuel used in special mobile will be subject to sales tax rather than motor fuel tax. This change will result in a small but unknown reduction in Highway Fund revenues and a corresponding increase in General Fund revenues. Section 27 of this act increases the registration fee for special mobile equipment from $20 to $40, effective January 1, 2000. This increase should generate about $40,000 or more in annual Highway Fund revenues to offset the decrease that will result from the motor fuel tax changes in Sections 22 and 24.

Section 28 of this act expands the maximum width of special mobile equipment from 96 inches to 102 inches. Section 29 of this act provides that vehicles being towed by special mobile equipment may carry property that does not exceed the weight of the towed vehicle. These sections, effective August 10, 1999, conform the law to reflect prevailing practices with regard to special mobile equipment.

Miscellaneous Changes. The remaining sections of this act make minor changes to various tax law statutes.

- Political Parties Financing Fund. The law requires that the individual income tax return contain a line authorizing a contribution to the Political Parties Financing Fund. Section 3 of this act removes the requirement that the line be color-contrasted with the color scheme of the remainder of the return. Beginning next year, income tax returns will have a uniform ink color for

purposes of optical character reading. With the implementation of optical character reading, the color contrast requirement is not compatible with efficient processing of the millions of tax returns filed each year because the contrast color would interfere with recognition of the proper fields.

- Definition of a Utility for Sales Tax Purposes. Sections 4 and 12 clarify the definition of a utility for sales tax purposes. Under prior law, the definition contained a sales exemption for municipalities that are supplied electricity by the federal government and are required to make payments in lieu of taxes. These sections move the exemption from the definition statutes to the exemption statutes. Under prior law, the definition included electric power companies subject to the gross receipts tax under G.S. 105-116. In anticipation of a possible rewrite of the gross receipts tax statutes as part of deregulation, these sections remove the cross-reference to the gross receipts tax and clarify that all sellers of electric power are considered utilities for sales tax purposes.

- No Sales or Use Tax/Certain Tangible Personal Property. Section 11 of this act provides that sales and use taxes do not apply to tangible personal property that a merchant manufactures or purchases for resale but then withdraws from inventory and donates to a governmental entity, effective October 1, 1999. This change is not expected to have significant impact on General Fund revenues. The prior law granted a tax exemption only for property donated to a nonprofit organization. In some cases, merchants donate property to schools or other governmental entities; this change allows these donations to benefit from the same sales tax exemption as donations to nonprofits. 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. Without these specific exemptions for donations, a merchant who donates to charity would become liable for sales and use tax.

- Increase Restaurant Services Charges Not Subject to Sales Tax. Section 13 of this act increases the amount of the service charge that may be added to a restaurant patron's bill without being subject to sales tax, effective October 1, 1999. Under prior law, sales tax applied to a service charge added to the sales price of food and beverages unless the service charge (1) did not exceed 15%, (2) was stated separately on the menu and the bill, and (3) was turned over to the personnel who served the meals. This section increases the maximum percentage of the service charge from 15% to 20%, to reflect the current

practice in some restaurants. If the three conditions are met, the service charge is considered a tip and is not part of the sales price for sales tax purposes.

- Information Sharing/DOR and Law Enforcement. Section 18 of this act amends the tax secrecy law effective August 10, 1999, to allow the Department of Revenue to share with law enforcement agencies information about the tobacco products excise taxes, alcoholic beverages excise taxes, and unauthorized substances excise taxes, when this information is needed to fulfill a duty imposed on the Department of Revenue or on the law enforcement agency. The Department of Revenue works closely with law enforcement agencies to enforce the excise taxes on controlled substances and illicit liquor.

- Repeal Certain Motor Fuel Tax Licenses. Sections 20 and 21 of this act repeal the requirement that bulk end users and retailers of undyed diesel fuel get a motor fuel tax license, effective August 10, 1999. The licenses are not necessary because the Department of Revenue can obtain the same information from the Department of Agriculture and Consumer Services. Because there was no fee for these licenses, their repeal will have no fiscal impact.

  A motor fuel supplier that files a timely motor fuel tax return is allowed a discount of 0.1% of the tax due, not to exceed $8,000 a month, to cover the supplier's expenses incurred in collecting the motor fuel tax. Section 23 of this act clarifies that the discount is allowed only if the tax is paid on time, effective August 10, 1999.

  Under prior law, a bonded importer of motor fuel was required to obtain an import confirmation number using a transport truck to import fuel obtained from a supplier that is not a trustee for remittance of the motor fuel tax to the State on behalf of the importer. Section 25 of this act repeals this requirement effective August 10, 1999. The Department of Revenue requested this change, which is not expected to have any fiscal impact. The Department determined that the import confirmation number was not necessary because there are very few bonded importers in this category and the suppliers from whom they obtain the fuel have been collecting the tax and remitting it to the Department.

- DOR Authorized to Use State Directory of New Hires. Section 30 of this act allows the Department of Revenue to use information in the State Directory of New Hires for the purpose of administering the taxes it has a duty to collect. The State Directory of New Hires was established in 1997 to assist in

the location of persons owing child support. The Department of Health and Human Services maintains the Directory. Every employer in the State must report to the Directory the hiring of every employee for whom a federal W-4 form is required to be completed. The report must contain the name, address, and social security number of the newly hired employee and the name, address, and federal and State tax ID numbers of the employer. This section became effective August 10, 1999.

TAX LIEN ADVERTISEMENT & COLLECTION

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-439	HB 120	Representative Owens

AN ACT TO IMPROVE THE PROCEDURES FOR NOTIFYING OWNERS AND ADVERTISING TAX LIENS ON REAL PROPERTY.

OVERVIEW: This act makes the following changes relating to property tax collection, effective January 1, 2001:

- In the case of real property that the owner transferred after the January 1 visitation date, the taxing unit's newspaper advertisement of tax liens for delinquent taxes must be in the name of the person to whom the property was transferred.
- Before the newspaper advertisement is published, the tax collector must mail a notice to the listing owner and, if the listing owner has transferred the property after the visitation date, to the person to whom the property was transferred.
- It allows the taxing unit to begin in rem foreclosure proceedings 30 days after the tax liens are advertised, rather than waiting six months as required under prior law.

FISCAL IMPACT: Small, one-time impact on the costs of county operations.

EFFECTIVE DATE: January 1, 2001.

BACKGROUND & ANALYSIS: Property must be listed for property tax in January of each year. The listing owner is the taxpayer who owned the property as of January 1 (the visitation date). The listing owner is liable for property taxes for the fiscal year beginning July 1 following the visitation date, even if the property is transferred to another person after the visitation date. The taxes become due in September and become delinquent on January 6 of the following year. Although most counties send tax listing notices and tax bills to the taxpayer, they

are not required by law to do so. Property owners are charged with notice that they must list their property for taxes and pay the taxes; otherwise, enforcement measures will be taken against the property. The legal effect of this law is to prevent a taxpayer from using lack of notice as an excuse for not paying property taxes or as a defense to a collection remedy against the property.

If property taxes remain unpaid by February of the fiscal year in which they become due, the taxing unit (a county, city, or taxing district) is required by statute to order the tax collector to advertise the tax liens in a local newspaper under the name of the listing owner. This act provides that the tax collector must send a notice of the amount of the tax liens by first class mail at least 30 days before the tax lien advertisement is to be published. The notice must go to the person who listed the property (the listing owner) and, if the property was transferred during the one-year period beginning on the January 1 visitation date preceding the fiscal year in which the taxes become due, also to the person to whom the property was transferred (the record owner).

This act also changes the content of the tax lien advertisement. Under prior law, the advertisements contained the listing owners' names followed by a description of the property and the amount of delinquent tax due. This act provides that each parcel's tax lien will be noted under the record owner's name rather than the listing owner's name if the property was transferred after the January 1 visitation date preceding the fiscal year the taxes become due.

If delinquent property taxes remain unpaid after the advertisement of the tax lien, the tax collector may begin an in rem foreclosure proceeding against the property. Under prior law, the tax collector was required to wait six months after the advertisement before foreclosing. The earliest tax liens can be advertised is March; therefore, September was the earliest an in rem foreclosure proceeding could be initiated. Because a local government's fiscal year begins July 1, the collection of property taxes through an in rem foreclosure proceeding could not begin until the succeeding fiscal year after the taxes are due. This act allows the tax collector to initiate an in rem foreclosure proceeding as early as 30 days after the tax liens were advertised. This change enables collectors to collect the taxes in the fiscal year in which they are due.

REGIONAL TRANSPORTATION AUTHORITY AMENDMENTS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-445	HB 937	Representative Gray

AN ACT TO AMEND THE REGIONAL TRANSPORTATION AUTHORITY ACT CONCERNING JURISDICTION OF THE ENTIRE AREA OF THE COUNTY IN CERTAIN CIRCUMSTANCES AND MEMBERSHIP OF THE AUTHORITY, AND TO AUTHORIZE THE AUTHORITY TO CREATE SPECIAL TAX DISTRICTS WITHIN ITS JURISDICTION.

OVERVIEW: The act makes the following three changes affecting regional transportation authorities:

- Jurisdiction of Piedmont Authority for Regional Transportation. It expands the jurisdiction of a regional transportation authority (Piedmont Authority for Regional Transportation) to include the entire area of any county that has a member of its board of commissioners serving on the authority's board of trustees.
- Membership of Piedmont Authority for Regional Transportation. It expands the board of a regional transportation authority (Piedmont Authority for Regional Transportation) to include the chair of the airport authorities of the two most populous counties within the authority's jurisdiction.
- Special Tax Districts. It provides that a regional transportation authority (the Piedmont Authority for Regional Transportation) may create special tax districts consisting of one or more entire counties within the authority's jurisdiction and may levy its taxes within the special districts to the extent the taxes have not already been levied throughout the entire jurisdiction of the authority. The authority may not levy or increase a tax within the special district unless the board of commissioners of each county in the special district has adopted a resolution approving the levy or increase.

FISCAL IMPACT: The above changes affect only local revenues.

EFFECTIVE DATE: August 10, 1999.

BACKGROUND & ANALYSIS: In 1997, the General Assembly enacted S.L. 1997-417, which authorized a regional transit authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting passenger motor vehicles and motorcycles. The tax was expanded by S.L. 1999-452 to include property-hauling vehicles under 7,000 pounds. The tax applies only to short-term rentals, i.e., rentals for a period of less than one year. The tax is collected by the authority but is otherwise administered in the same way as the optional highway use tax on gross receipts from vehicle rentals. This optional highway use tax is 8% on short-term rentals, so the combined tax within the jurisdiction of the authority would be 13% if the authority levies the full 5%.

Each authority may use the proceeds of the tax for its public transportation purposes. Before levying or increasing the tax, the authority must obtain approval from each county in the region.

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. The Authority created under Article 27 is the Piedmont Authority for Regional Transportation, which serves Forsyth, Guilford, Randolph, Davidson, and Alamance Counties.

The 1997 law also authorized the Piedmont Authority for Regional Transportation and any multi-county public transportation authorities organized under pre-existing law to levy a $5 vehicle registration tax identical to the tax already authorized for, and levied by, the existing Triangle Transit Authority. A public transportation authority is an entity created by one or more local government entities under Article 25 of Chapter 160A of the General Statutes to provide public transportation. There are three multi-county public transportation authorities. The Choanoke Public Transportation Authority consists of Bertie, Halifax, Hertford, and Northampton Counties. The Kerr Area Transportation Authority consists of Franklin, Granville, Person, Vance, and Warren Counties. The Inter-County Public Transportation Authority consists of Camden, Chowan, Currituck, Pasquotank, and Perquimans Counties.

An authority must obtain the approval of each county within its jurisdiction before it can levy the $5 vehicle registration tax. The Division of Motor Vehicles will collect the tax in counties that are entirely located within the authority's jurisdiction. If the authority's jurisdiction includes just part of one or more counties, the authority will collect the registration tax in those parts of counties. The authority may contract with local governments to collect this tax.

Jurisdiction of Piedmont Authority for Regional Transportation. Under prior law, the jurisdiction of a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) included all or part of five contiguous counties whose boards of commissioners have representatives on the board of trustees, and included parts of other contiguous counties if the boards of commissioners of the affected counties consented by resolution. The authority's board of trustees could choose to add a member of the affected county's board of commissioners to the board of trustees. Section 1 of the act provides that if a member of an affected county's board of commissioners has been added to the authority's board of trustees, the

authority's jurisdiction includes the entire area of the county. By expanding the jurisdiction of an authority, this change expands the authority's taxing power.

Membership of Piedmont Authority for Regional Transportation. The act expands the membership of a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) to include the chair of the principal airport authority or airport commission of each of the two most populous counties within the authorities jurisdiction. In the case of the Piedmont Authority for Regional Transportation, this means the chair of the Forsyth County Airport Commission and the chair of the Piedmont Triad Airport Authority.

Special Tax Districts. A regional transportation authority (either the Triangle Transit Authority or the Piedmont Authority for Regional Transportation) may levy within its jurisdiction the vehicle rental tax of up to 5% and the vehicle registration tax of up to $5, as described above. The act provides that if a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) has not levied either tax up to the maximum rate, it may create a special tax district within its jurisdiction consisting of the entire area of one or more counties. The authority may levy within the special tax district the balance of either or both taxes, up to their maximum rates. The proceeds of a tax levied within a special tax district may be used only for public transportation purposes for the benefit of the special district. The levy and administration of a tax within a special district, like that of a tax within the entire jurisdiction of the authority, may not be levied unless there is a public hearing and each county in the special district has approved the tax. In addition, the authority may not levy or increase a tax within the special district unless the board of commissioners of each county in the special district has adopted a resolution approving the levy or increase.

MOTOR VEHICLE TECHNICAL AMENDMENTS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-452	HB 280	Representative Cole

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER CHANGES TO THE MOTOR VEHICLE LAWS.

OVERVIEW: This act makes numerous changes to the motor vehicle laws and two changes to the tax laws. The tax law changes are:

- Transit Authority Vehicle Rental Tax. An expansion of the scope of the transit authority vehicle rental tax to include more types of vehicles.
- DOR to Share Motor Fuel Tax Information. An expansion of the Department of Revenue's authority to share motor fuel tax information to help in collecting motor fuel taxes.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: October 1, 1999.

BACKGROUND & ANALYSIS:

Transit Authority Vehicle Rental Tax. Sections 26 through 28 of this act broaden the scope of the transit authority vehicle leasing tax to include certain property-hauling vehicles, effective October 1, 1999. A regional transit authority may levy a gross receipts tax on a retailer who leases or rents vehicles. The tax rate may not exceed 5% of the gross receipts derived from the short-term (less than 365 continuous days) lease or rental of the vehicles. This tax is added to the lease or rental price and paid by the lessee. This act broadens the scope of this tax from its current scope (U-drive-it passenger vehicles and motorcycles) to include U-drive-it property-hauling vehicles as well. A U-drive-it vehicle is defined in G.S. 20-4.01 as any of the following rented to a person who will operate it: a motorcycle; a property hauling vehicle under 7,000 pounds rented for a term of less than one year (and not hauling products for hire); and a private passenger vehicle rented for a term of less than one year (and not rented to public schools for driver training instruction).

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. The Authority created under Article 27 is the Piedmont Authority for Regional Transportation, which serves Forsyth, Guilford, Randolph, Davidson, and Alamance Counties.

DOR Authorized to Share Motor Fuel Tax Information. The tax secrecy law authorizes the Department of Revenue to exchange taxpayer information with the Division of Motor Vehicles to the extent necessary for these agencies to fulfill their duties. Section 28.1 of this act amends this provision to allow the Department of Revenue to exchange information with the International Fuel Tax Association, Inc., as well, effective October 1, 1999. The International Fuel Tax Association is a nonprofit, membership organization whose mission is to provide oversight, planning, and coordination of activities necessary to promote uniform

administration of the International Fuel Tax Agreement (IFTA). The IFTA is an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor fuel. These taxes are frequently referred to as road taxes or highway use taxes and are not to be confused with the motor vehicle titling tax enacted in 1989 that is also referred to as a highway use tax. The road tax is a tax on the amount of fuel a motor carrier uses in its operations in a state. The tax is at the same rate as the state's per-gallon excise tax on motor fuel and a credit is given for excise taxes paid to the state on motor fuel. Thus, the purpose of the tax is to tax motor carriers who drive in a state using fuel purchased in another state.

Under the IFTA, a motor carrier declares one member jurisdiction to be the carrier's base jurisdiction for registering the carrier's vehicles for purposes of the road taxes and reporting the taxes due to all the member jurisdictions. The base jurisdiction then collects the road taxes payable by the motor carrier to every member jurisdiction and remits the taxes collected to the appropriate jurisdictions. By centralizing the payment and collection of road taxes, the agreement greatly simplifies the payment of road taxes by motor carriers and the collection of road taxes by the member jurisdictions.

MUNICIPAL INCORPORATION PROCESS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-458	HB 964	Representative Jarrell

AN ACT TO REVISE THE MUNICIPAL INCORPORATION PROCESS SO AS TO PROVIDE MORE SCRUTINY.

OVERVIEW: This act makes four changes to the municipal incorporation process:

- Changes to Criteria for Municipal Incorporation.
    - It requires that a petition filed with the Joint Legislative Commission on Municipal Incorporations contain a statement that the proposed municipality will have a budget ordinance with a property tax levy of at least five cents per $100.00 valuation upon all taxable property within its corporate limits and that the proposed municipality will offer four municipal services no later than the first day of the third fiscal year following the date of incorporation. This change applies to

municipalities for which the Commission makes recommendations on or after August 13, 1999.

- It changes the criteria for incorporation that the Joint Legislative Commission on Municipal Incorporations considers when making its recommendation to the General Assembly on whether an area should be allowed to incorporate. Among these changes is the repeal of the development criteria in G.S. 120-169.1(a). This repeal is effective August 13, 1999.

- Distribution of State-Shared Revenues and Local Sales Tax Revenues.
  - It provides that a municipality, incorporated on or after January 1, 2000, may not receive local sales tax revenues or State-shared tax revenues unless it levies a property tax at a rate of at least five cents per $100.00 valuation upon all taxable property within its corporate limits, collects at least 50% of the property tax due, and provides at least four municipal services.
  - It provides that a municipality, incorporated on or after January 1, 2000, may not receive State-shared revenues or local sales tax revenues unless a majority of the mileage of its streets is open to the public.

The above changes, other than the repeal of the criteria for incorporation in G.S. 120-169.1(a), do not apply to any community that first filed a petition with the Joint Legislative Commission on Municipal Incorporations before July 20, 1999. These changes also do not apply to the Community of Gray's Creek in Cumberland County nor to the Community of Union Cross in Forsyth County if either community files a petition with the Commission before July 1, 2002.

FISCAL IMPACT: Unable to determine.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS: In 1985, the General Assembly created the Joint Legislative Commission on Municipal Incorporations. [12] Although a municipality does not need the recommendation of the Commission to be incorporated, it is highly encouraged. Also Rule 35.1 of the permanent rules of the Regular Sessions of the House of Representatives of the 1999 General Assembly requires that a municipality seeking incorporation have an assessment report from the Commission before the House of Representatives may consider it.

[12] This Commission consists of two senators, two House members, one city manager or elected city official, and one county commissioner or county manager. (G.S. 120-158)

Criteria for Municipal Incorporation. Prior to this act the Commission was required to give the proposed area to be incorporated a positive recommendation if the area met all of the following criteria:

- Petition requirements and notice requirements have been met.
- The proposed municipality is not located within one mile of a city of 5,000 to 9,999; within three miles of a city of 10,000 to 24,999; within four miles of a city of 25,000 to 49,999; or within five miles of a city of 50,000 or more. G.S. 120-166(b) sets out four exceptions to this requirement.
- The proposed municipality has a permanent population of at least 100.
- At least 40% of the area is developed for residential, commercial, industrial, institutional, or governmental uses, or is dedicated as open space. This requirement does not apply if the entire proposed municipality is within two miles of the Atlantic Ocean, Albemarle Sound, or Pamlico Sound.
- None of the proposed municipality is located within an existing municipality.
- The proposed municipality can provide at a reasonable tax rate the services requested by the petition and also can provide at a reasonable tax rate the types of services usually provided by similar municipalities.
- The proposed municipality plans to provide at least two municipal services.

The act changes the above criteria for municipal incorporation as follows:

- It adds a new requirement that the proposed municipality have a proposed budget ordinance with a property tax rate of at least five cents per $100.00 valuation upon all taxable property within its corporate limits. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
- It increases the number of services the proposed municipality must plan to provide from two to four. These services must be provided within the third fiscal year of incorporation. The types of services the municipality can offer include police protection, fire protection, solid waste collection or disposal, water distribution, street maintenance, street construction, street lighting, and zoning. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
- It adds a requirement that the proposed municipality must have a population density of at least 250 persons per square mile. This is in addition to the pre-existing requirement of a permanent population of at least 100 persons. This change does not apply to any community that first filed a petition with the Commission before July 20, 1999.
- It removes the exception from the requirement that at least 40% of the area be developed for urban uses or dedicated as open space. This exception

applied to a proposed municipality located within two miles of the Atlantic Ocean, Albemarle Sound, or Pamlico Sound. This change does not apply to any community that first filed a petition with the Commission before July 20, 1999.

- It repeals the development criteria set out in G.S. 120-169.1(a) of the General Statutes because it was in conflict with a pre-existing requirement for municipal incorporation. G.S. 120-169.1(a), enacted by the General Assembly in 1998, prohibited the Commission from making a positive recommendation on the proposed incorporation, unless the entire area met the development criteria for involuntary annexation set out in G.S. 160A-36(c) or G.S. 160A-48(c) of the General Statutes. These two sections of Chapter 160A required a higher percentage of urban use in the proposed municipality than the pre-existing requirement of 40% in G.S. 120-168. The repeal of G.S. 120-169.1(a) became effective August 13, 1999.
- It adds a requirement that the Commission must include in its report the impact on other municipalities and counties of the diversion of already levied local taxes and State-shared revenues to support services in the proposed municipality. This requirement does not apply to any community that first filed a petition with the Commission before July 20, 1999.

Distribution of State-Shared Revenues and Local Sales Tax Revenues. Cities receive the following State-shared taxes: the franchise tax in Article 3 of Chapter 105 on telephone companies, electric power companies, natural gas companies, and regional natural gas districts; the tax on motor fuel and alternative fuel in Articles 36C and 36D of Chapter 105; and the excise tax on malt beverages and wine in Part 4 of Article 26 of Chapter 105. Together these taxes contribute 10% to 25% of a city's general fund revenue. Under prior law, a municipality did not need to meet any conditions to receive local sales tax distributions. However, to receive motor fuel and alternative fuel tax revenue, known as Powell Bill funds, a municipality had to meet the following conditions:

- It has levied a property tax for the current fiscal year of at least five cents per $100.00 valuation upon all taxable property within its corporate limits.
- It has actually collected at least 50% of the total property tax levied for the preceding fiscal year.
- It has adopted a budget ordinance showing revenue received from all sources and showing that funds have been appropriated for at least two of the following services: water, wastewater, garbage collection, fire protection, police protection, street maintenance, or street lighting.

Pursuant to G.S. 136-41.1, the Powell Bill funds are allocated to municipalities based upon the municipality's population and the municipality's mileage of public streets that are not part of the State highway system. A municipality may

use Powell Bill funds only for the purpose of maintaining, repairing, constructing, reconstructing, or widening public streets.

Effective for municipalities incorporated on or after January 1, 2000, the act increases the number of services a municipality must offer from two to four in order to receive Powell Bill funds. It also places the same conditions on the other State-shared revenues as well as on local sales tax distributions. Therefore, for a municipality incorporated on or after January 1, 2000, to receive franchise tax revenues, malt beverage and wine tax revenues, and local sales tax revenues, it must meet all of the following conditions:

- It levies a property tax of at least five cents per $100.00 valuation.
- It collected at least 50% of the total property tax levied for the preceding fiscal year.
- Its adopted budget ordinance shows that funds have been appropriated for at least four of the following services - police protection, fire protection, solid waste collection, water distribution, street maintenance, street construction, street lighting, and zoning.

The act further bars the distribution of revenue to municipalities that do not have public streets. Effective for distributions of State-shared revenues and local sales tax revenues made on or after July 1, 1999, a municipality incorporated on or after January 1, 2000, may not receive State-shared revenues or local sales tax revenues unless a majority of the mileage of its streets are open to the public. In recent years at least two municipalities have been incorporated that do not have streets open to the public. They are Grandfather Village in Avery County (S.L. 1987-419) and the newly incorporated Bermuda Run in Davie County (S.L. 1999-94). Since these two municipalities were incorporated before January 1, 2000, this restriction would not apply.

APPENDIX C

DISPOSITION OF COMMITTEE RECOMMENDATIONS TO THE 1999 SESSION

Fate of Recommendations to 1999 Session

1. AN ACT TO ELIMINATE THE USE OF STAMPS TO INDICATE WHETHER THE EXCISE TAX ON CONVEYANCES HAS BEEN PAID AND TO MAKE THE PENALTIES THAT APPLY TO THIS TAX THE SAME AS FOR OTHER TAXES

   Enacted as S.L. 1999-28

2. AN ACT TO ADD FOUR NEW TAX ANALYSTS IN THE TAX RESEARCH DIVISION OF THE DEPARTMENT OF REVENUE

   Enacted as S.L. 1999-415

3. AN ACT TO ACT TO PROVIDE FOR PERIODIC REVIEW AND RENEWAL OF STATE TAX CREDITS

   House Bill 63 (Rep. Gray); In House Finance

4. AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES

   Enacted as S.L. 1999-337

5. AN ACT TO REQUIRE CORPORATIONS THAT ARE REQUIRED TO PAY FEDERAL ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER TO PAY STATE ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER

   Enacted as S.L. 1999-389

6. AN ACT TO UPDATE THE METHOD FOR DETERMINING THE PRESENT-USE VALUE OF AGRICULTURAL AND HORTICULTURAL LAND TO MORE ACCURATELY REFLECT ITS VALUE AS FARMLAND

   Senate Bill 73 (Sen. Hartsell); In Senate Finance

APPENDIX D

SUMMARY OF THE MEETINGS OF THE CONTINUING CARE RETIREMENT CENTER SUBCOMMITTEE OF THE REVENUE LAWS STUDY COMMITTEE

SUMMARY OF MEETINGS OF THE CONTINUING CARE RETIREMENT CENTER SUBCOMMITTEE

The Continuing Care Retirement Center (CCRC) Subcommittee met on February, 15, February 28, March 17, March 27, April 11, and April 24, 2000. Attending the meetings have been representatives from the North Carolina Association of Non-Profit Homes for the Aging, the Continuing Care Community Residents of North Carolina, Inc., the Association of County Commissioners, the N.C. Department of Revenue, the Tax Assessors Association, the Institute of Government, The Pines of Davidson, and legislative staff. Several members of the Revenue Laws Study Committee have also attended.

Issue Before the Subcommittee

How should the CCRCs that are currently exempt from property taxes under G.S. 105-278.6A be treated when this exemption sunsets on July 1, 2000? This statute gives a property tax exemption to certain CCRCs that fail to qualify as charitable under G.S. 105-278.6. When refusing to classify a facility as charitable, the North Carolina Courts have noted the following facts:

1. The institution refused to admit applicants with health problems rendering them physically unable to care for themselves.
2. Substantial entrance fees and monthly fees were required from all residents, and applicants had to demonstrate that they were financially capable of supporting themselves for the period of their life expectancy.
3. The operation of the institution was funded entirely or mainly from fees paid by residents, not by donations or endowments.
4. The costs were so high that only a small percentage of the elderly could afford the center.
5. The center retained the right to terminate a resident for nonpayment of fees unless nonpayment was beyond the resident's control.

February 15, 2000 Meeting

The subcommittee discussed the following options to the CCRC issue:

- Do nothing. This would mean that most CCRCs would lose their property tax exemption on July 1, 2000. Some CCRCs could qualify for exemption under G.S. 105-278.6 or under the Health Care Facilities Finance Act.
- Remove the sunset provision on the CCRCs. The CCRCs that are exempt under G.S. 105-278.6A would continue to be exempt.
- Extend the sunset for one year. This would allow the CCRCs one more year of tax exempt status.
- Exempt CCRCs if they are nonprofit and meet a minimum standard of charitable care and/or community benefit.
- Reduce the assessed value of CCRCs by the value of the community benefit and/or charitable care that the CCRC provides.
- Reduce the assessed value of CCRCs by the number of residents of the Center who qualify for the homestead exemption because of their age and income.

- Allow the CCRCs to make payments in lieu of taxes. These payments could be calculated in accordance with the actual cost of providing municipal services to the CCRC and to the persons who reside there.

February 28, 2000 Meeting
The CCRC representatives gave a power point presentation on software that is available nationwide and used by a few North Carolina CCRCs and hospitals to measure their social accountability or community benefit. The subcommittee **agreed** on the following proposal:

1. The tax exemption for homes for the aged, sick or infirm that are exclusively occupied and used for charitable purposes will remain the same. (G.S. 105-278.6)
2. CCRCs that contain a nursing home or skilled nursing facility that would be exempt under G.S. 105-278.6 if the nursing home or facility were not part of a CCRC, will be exempt.
3. The assessed tax value of a CCRC would be reduced by an amount calculated by multiplying the number of residents in the CCRC who would qualify for the homestead exemption by $20,000 or the current exemption level.

The subcommittee **disagreed** over property tax relief for charity care and community benefit.

The subcommittee also reviewed and approved draft legislation that would clarify the extent of the property tax exemption allowed to health care facilities that have been issued bonds by the Medical Care Commission under the Health Care Facilities Finance Act. The proposal provides that only the part of a facility for which bonds have been issued will be exempt from property taxes. This proposal was adopted by the Revenue Laws Study Committee at its March 7, 2000 meeting.

March 17 2000 Meeting
The subcommittee discussed the definitions for charity care and community benefit and whether these services should be valued as a tax credit or a reduction to the CCRC's assessed value.

March 27, 2000 Meeting
Staff Attorney Martha Walston informed the subcommittee that Bill Campbell, with the Institute of Government, and Legislative Staff believed that a property tax credit could be unconstitutional. The State Constitution provides for classifications of property and exemptions to the property tax but does not provide for a tax credit. The subcommittee then agreed that if tax relief is given for the value of charity care and/or community benefit provided by the CCRC, then the value of the care and/or benefit would be multiplied by a factor and the product subtracted from the assessed value of the CCRC. Depending upon the amount of the factor, this could give the CCRCs the equivalent of a

tax credit. The subcommittee then continued to discuss the definitions of charity care and community benefit.

Remaining issues:

- Should property tax relief be provided for charity care and/or community benefit?
- If property tax relief is provided for charity care and/or community benefit then by what factor should the value of this care and/or benefit be multiplied before it is subtracted from the assessed value of the CCRC? Should this factor give the CCRCs the equivalent of a tax credit or should the factor be less?
- Should the definition of charity care include only truly uncompensated care or the Medicaid/ Medicare gap? The Medicaid/Medicare gap is the difference between the actual cost of a service and the amount Medicaid or Medicare actually pays to the CCRC for the service. There is a concern that if the definition includes this gap then for-profit nursing homes, that also provide Medicaid services, will seek the same property tax relief.
- Should the definition of charity care include only uncompensated care and the Medicaid gap?
- If the Medicaid/Medicare gap is included in the definition of charity care, should the definition also include both direct costs and indirect costs? Direct costs are costs for services provided, and indirect costs are costs of running the facility.
- Should the definition of community benefit be defined as the uncompensated portion of services provided primarily to the elderly in the community for the purpose of health, education, or research?
- Should the definition of community benefit be confined to services that the government would have to provide if the CCRC did not provide them?
- Should the community benefit provided by the CCRC be restricted to those provided on the facility's premises?

April 11, 2000 Meeting

The subcommittee continued to discuss the above issues and examined data showing the Medicaid gap incurred by some of the CCRCs. The subcommittee also looked at the Texas legislation which provides for a property tax exemption for CCRCs in which at least 4% of the CCRC's combined net resident revenue is provided in charitable care to its residents. The Texas legislation was to be discussed at the next meeting.

April 24, 2000 Meeting

The subcommittee reviewed a proposal recommended by the CCRC representatives which would give a property tax exemption to CCRCs that provide a percentage of charity care or community benefits to its residents. The charity care or community benefits provided would have to equal a minimum percentage of the facility's combined net resident revenue. The group continued to discuss definitions for charity care and community benefits, but indicated they could not agree on these definitions until data was received on the amount of direct charity care, Medicaid, and Medicare services provided by the CCRCs. However, the subcommittee did agree that any property tax exemption

allowed CCRCs should be based upon the CCRC providing a percentage of charity care or community benefit that was equal to or greater than a certain percentage of resident revenues. Since there was no agreement to the CCRC proposal, the subcommittee agreed to recommend a bill to the Revenue Laws Study Committee that would extend the sunset on the property tax exemption for CCRCs until July 1, 2001.

Remaining issues:

- How should charity care be defined?
- How should community benefit be defined?
- How should resident revenue be defined?
- What percentage of charity care and/or community benefit should the CCRC provide in order to qualify for a property tax exemption?
- Should any exemption for charity care and/or community benefit be a graduated exemption?

The parties attending the subcommittee expressed their desire to continue meeting during the Short Session in hopes of reaching a permanent agreement on the tax status of CCRCs.