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2001 REPORT OF THE REVENUE LAWS STUDY COMMITTEE

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REPORT TO THE 2001 GENERAL ASSEMBLY OF NORTH CAROLINA

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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

January 24, 2001

TO THE MEMBERS OF THE 2001 GENERAL ASSEMBLY:

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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Martha Walston, Committee Co-Counsel

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 nine times during the 1999-2000 interims. It met four times before the convening of the 2000 Regular Session of the 1999 General Assembly and it met five times after the adjournment 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. Appendix B includes a list of the issues referred to the 1999-2000 Revenue Laws Study Committee. The Committee considered 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.

At its first meeting following the adjournment of the 2000 Regular Session of the 1999 General Assembly, the Revenue Laws Study Committee first reviewed the tax law changes enacted during the 2000 Session and the fate of the Committee's recommendations to that session. Ten of its 11 proposals to the 2000 Session were enacted in whole or in part in 2000. Appendix C lists the Committee's recommendations and the action taken on them in 2000. A document entitled "**2000 Tax Law Changes**" summarizes all of the tax legislation enacted in 2000. It is available in the Legislative Library located in the Legislative Office Building.

The Revenue Laws Study Committee began an in-depth study of three major issues during the 1999 interim. The Committee continued its work in these three areas this past interim:

- 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.

Last year the Committee recommended, and the General Assembly enacted, legislation to enable North Carolina to participate in the streamlined sales tax collection system project. The project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration. The project incorporates uniform definitions within tax bases, simplified audit and administrative procedures, and emerging technologies to substantially reduce the burdens of tax collections. The Streamlined Sales Tax System is focused on improving sales and use tax administration systems for both Main Street and remote sellers for all types of commerce. At least 39 of the 45 states that have a sales and use tax are participating in the project. Legislative Proposal 10 builds upon the work started by this Committee last year. It gives the Secretary of Revenue the authority to enter into the Streamlined Sales and Use Tax Agreement and sets forth the requirements of the Agreement. It also begins incorporating the uniform definitions that will be required for states to participate in the Agreement.

Last year, 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. Legislative Proposal 1 is the recommendation of this subcommittee to the Revenue Laws Study Committee. It represents a compromise

reached by representatives from the CCRCs, the NC Department of Revenue, the NC Association of County Commissioners, and the NC Tax Assessors and Collectors. It provides a property tax exclusion for certain qualified retirement facilities that provide charity care and/or community benefits. The percentage of the exclusion depends upon the percentage of the facility's resident revenue that is provided in charity care, in community benefits, or in both.

The Committee began discussions on a similar issue during its December meetings - the taxability of nonprofit charitable hospitals. Over the past decade, a larger percentage of property has been removed from the tax rolls under the nonprofit charitable hospital exclusion. The current law does not have a clear definition of a "hospital" and its definition of "charitable hospital purpose" is very broad. The Committee plans to continue its work in this area next fall. The Committee hopes to reach a consensus on this issue in much the same way it reached a consensus on the CCRC issue. In that hope, the Committee encouraged the interested parties to begin discussing the issues with each other prior to the Committee's meeting next fall.

Legislative Proposal 12 represents the Committee's recommendation regarding telecommunications. It is substantially the same as the Committee's recommendation to the 2000 Regular Session, Senate Bill 1320. 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 12 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 broadens 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 Revenue Laws Study 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 13, 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 State tax law will be consistent with recent federal law changes, at least to the extent State law already piggybacks federal law.

Legislative Proposal 5 provides for the waiver of penalties for failure to obtain a license, file a return, or pay a tax due at the State level during the time federal tax-related deadlines are extended because of a Presidentially declared disaster. After Hurricane Floyd, the extension of time at the State level did not conform to the extension of time at the federal level. This discrepancy resulted in some North Carolina taxpayers filing their State returns and making payments on the IRS extension date, rather than the earlier State extension date. This proposal makes the tax deadlines easier to comply with in the future by providing that certain tax-related deadlines extended at the federal level because of Presidentially declared disasters will automatically result in the waiver of State penalties during the extension.

The Revenue Laws Study Committee received a progress report from the Department of Revenue on the individual income tax form revisions. The Department has devised a new software income tax form for electronic returns. There is a scan band on the return that will enable the returns to be read by the Department. The purpose of the new form is to enable the Department to process returns faster and more accurately.

As in the past, the Revenue Laws Study Committee proved to be an excellent forum for taxpayers, local government officials, and State tax administrators to propose changes in the revenue laws. Legislative Proposal 2 would provide greater property tax relief to low-income elderly and disabled homeowners by increasing both the homestead exclusion amount and the income eligibility limit. The North Carolina Association of Assessing Officers recommended the proposal to the Committee. The proposal indexes the income eligibility limit of $15,000 by a percentage equal to the percentage cost-of-living adjustment used to increase social security benefits for the preceding calendar year, effective for the 2002 property tax year. The proposal also changes the exclusion amount from $20,000 to the greater of $20,000 or 50% of the tax value of the property. The proposal does not address the issue of reimbursing local governments for any revenue loss sustained as a result of increasing the exclusion amount or indexing the income eligibility limit. Legislative Proposal 3 also addresses property tax issues. It makes several changes to the property tax laws recommended by the Department of Revenue, the Institute of Government, and the North Carolina Association of Assessing Officers.

Legislative Proposal 4 addresses a reduction in the property tax base experienced by some rural eastern counties. Current State and federal laws encourage wetlands restoration and protection. Under certain circumstances, wetlands may be disturbed if other wetlands are protected in mitigation. When land is purchased by government agencies under a mitigation process, the property is removed from the tax levy. Legislative Proposal 4 seeks to strike a balance between wetlands mitigation efforts and the revenue-raising base for a tier 1 or tier 2 county by requiring, in some circumstances, that the county receive some payment in lieu of taxes for 10 years after the land is removed from the tax rolls.

The Revenue Laws Study Committee recommends several legislative proposals that seek to enhance the efficiency and fairness of tax administration. Legislative

Proposal 7 corrects a provision in the statute regarding allocation of partnership tax credits to apply specific dollar amount limitations to the total credit allocated by the partnership, effective 2002. Legislative Proposal 8 clarifies the franchise tax liability of limited liability companies. Legislative Proposal 9 equalizes the sales tax applicability to computer software by modifying the sales and use tax on software to include software that is delivered electronically.

The State Auditor's Office presented to the Revenue Laws Study Committee a summary of its performance audit of the Department of Revenue. The audit's major conclusions were that the Department of Revenue is operating effectively given its current level of staffing and technology and that the benefits from technology are a 4.8% per year increase in tax revenues, or $726 million per year. The performance audit made recommendations in three major areas: (1) that the State can generate additional revenues through collection and technology changes, including millions of dollars from five specific proposals; (2) that the Department of Revenue can use technology to improve services to citizens; and (3) that the Department of Revenue needs additional staff and continued technology funding to perform its duties more effectively. Appendix D includes a press release from the Auditor's Office concerning the performance audit as well as the audit's Executive Summary and a chart summarizing the audit's recommendations.

The Revenue Laws Study Committee adopted Legislative Proposal 6, Supporting Legislation Implementing the Recommendations made by the Office of the State Auditor in its Report on the Performance Audit of the Department of Revenue. The Committee did not adopt a specific bill, but decided to support legislation that is being developed jointly by the Office of the State Auditor and the Department of Revenue as part of the work of the North Carolina Tax Policy Study Commission. The Tax Policy Study Commission considered draft legislation on January 17, 2001 to appropriate funds to the Department of Revenue for new positions recommended by the State

Auditor's Performance Audit. A copy of that draft legislation is found in Appendix E. The Tax Policy Study Commission amended the draft legislation to include an appropriation of funds to the Department of Revenue for technology. The Tax Policy Study Commission adopted, and the Revenue Laws Study Committee supports, the draft legislation as amended.

Finally, the Revenue Laws Study 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 11, providing technical, clarifying, and conforming changes to the revenue laws and related statutes.

The Revenue Laws Study Committee is not recommending any changes to the William S. Lee Quality Jobs and Business Expansion Act this year. However, the Committee spent considerable time examining the accountability measures included in the Act. It received briefings from both the Department of Commerce and the Department of Revenue on the certification process and the audit requirements. Appendix F contains some of the information received by the Committee on the Bill Lee Act safeguards, forfeitures, and reporting requirements.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee makes the following 13 recommendations to the 2001 General Assembly. Of these recommendations, 12 include draft proposals. 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

RETIREMENT HOME TAX CHANGE

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 1:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO PROVIDE A PROPERTY TAX EXCLUSION FOR CERTAIN QUALIFIED RETIREMENT FACILITIES THAT PROVIDE CHARITY CARE AND/OR COMMUNITY BENEFITS.

SHORT TITLE: Retirement Home Tax Changes.

BRIEF OVERVIEW: The proposal provides a property tax exclusion for certain qualified retirement facilities that provide charity care and/or community benefits. The percentage of the exclusion depends upon the percentage of the facility's resident revenue that is provided in charity care, in community benefits, or in both. The proposal is a compromise reached by a subcommittee composed of representatives from the CCRCs, the NC Department of Revenue, the NC Association of County Commissioners, and the NC Tax Assessors and Collectors.

FISCAL IMPACT: The proposal does not impact the State General Fund. It is expected to generate a minimum of $1.7 to $2.5 million for local governments.

EFFECTIVE DATE: The proposal is effective for property taxes imposed for taxable years beginning on or after July 1, 2001.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

2001-LAX-005

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

Short Title: Retirement Home Tax Change. (Public)

Sponsors: .

Referred to:

---

1 A BILL TO BE ENTITLED
2 AN ACT TO PROVIDE A PROPERTY TAX EXCLUSION FOR CERTAIN QUALIFIED
3 RETIREMENT FACILITIES THAT PROVIDE CHARITY CARE AND/OR
4 COMMUNITY BENEFITS.
5 The General Assembly of North Carolina enacts:
6 Section 1. G.S. 106-278.6A reads as rewritten:
7 **"§ 105-278.6A. (See editor's note for repeal date) Qualified**
8 **retirement facility.**
9 (a) Classification. -- ~~Real and~~ Buildings, the land they
10 actually occupy, additional adjacent land reasonably necessary
11 for the convenient use of the buildings, and personal property
12 owned by a qualified retirement facility and used in the
13 operation of that facility is designated a special class of
14 property under Section 2(2) of Article V of the North Carolina
15 Constitution and ~~shall~~ ~~not be listed, assessed, or taxed.~~ is
16 excluded from taxation to the extent provided in this section.
17 (b) ~~Facility Defined. -- As used in this section, the term~~
18 ~~"retirement facility" means a community that meets all of the~~
19 ~~following conditions:~~
20 ~~(1)~~ ~~Its grounds and buildings are at a single site.~~
21 ~~(2)~~ ~~It is designed for elderly residents.~~

~~(3) It includes independent living units for elderly residents.~~

~~(4) It includes a skilled nursing facility or an adult care facility.~~

Definitions. -- The following definitions apply in this section:

(1) Charity care. -- The unreimbursed costs to the facility of providing health care, housing, or other services to a resident who is uninsured, underinsured, or otherwise unable to pay for all or part of the services rendered.

(2) Community benefits. -- The unreimbursed costs to the facility of providing the following:

a. Services, including health, recreation, community research, and education activities provided to the community at large, including the elderly.

b. Charitable donations.

c. Donated volunteer services.

d. Donations and voluntary payments to government agencies.

(3) Financial reporting period. -- The calendar year or tax year ending prior to the date the retirement facility applies for an exclusion under this section.

(4) Resident revenue. -- Annual revenue paid by a resident for goods and services and one year's share of the initial resident fee amortized in accordance with generally accepted accounting principles.

(5) Retirement facility. -- A community that meets all of the following conditions:

a. It is licensed under Article 64 of Chapter 58 of the General Statutes.

b. It is designed for elderly residents.

c. It includes independent living units for elderly residents.

d. It includes a skilled nursing facility or an adult care facility.

(6) Unreimbursed costs. -- The costs a facility incurs for providing charity care or community benefits after subtracting payment or reimbursement received from any source for the care or benefits. Unreimbursed costs include costs paid from funds

1 generated by a program described in subdivision
2 (c)(5) of this section.
3 (c) ~~Qualification.~~ Total Exclusion. -- A retirement facility
4 qualifies for ~~the benefits of~~ total exclusion under this section
5 if it meets all of the following conditions:
6 (1) It is exempt from tax under Article 4 of this
7 Chapter and private shareholders do not benefit
8 from its operations.
9 (2) All of its revenues, less operating and capital
10 expenses, are applied to providing uncompensated
11 goods and services to the elderly and to the local
12 community, or are applied to an endowment or a
13 reserve for these purposes.
14 (3) Its charter provides that in the event of
15 dissolution, its assets will revert or be conveyed
16 to an entity that is organized exclusively for
17 charitable, educational, scientific, or religious
18 purposes, and is an exempt organization under
19 section 501(c)(3) of the Code.
20 ~~(4) Its charter or bylaws provide that it is governed~~
21 ~~by a board of directors or trustees at least a~~
22 ~~majority of whose members are selected by one or~~
23 ~~more nonprofit corporations or associations that~~
24 ~~meet all of the following conditions:~~
25 ~~a. It is exempt under section 501(c)(3), (8), or~~
26 ~~(10) of the Code.~~
27 ~~b. It is organized for a charitable purpose as~~
28 ~~defined in G.S. 105-278.6.~~
29 ~~c. It is not a private foundation as defined in~~
30 ~~section 509 of the Code.~~
31 (5) It has an active program to generate funds through
32 one or more sources, such as gifts, grants, trusts,
33 bequests, endowment, or an annual giving program,
34 to assist the retirement facility in serving
35 persons who might not be able to reside there
36 without financial assistance or subsidy.
37 (6) It meets at least one of the following conditions:
38 a. The facility serves all residents without
39 regard to the residents' ability to pay.
40 b. At least five percent (5%) of the facility's
41 resident revenue for the financial reporting
42 period is provided in charity care to its
43 residents, in community benefits, or in both.

(d) Partial Exclusion. -- A retirement facility qualifies for a partial exclusion under this subsection if it meets conditions (1) through (5) of subsection (c) of this section and at least one percent (1%) of the facility's resident revenue for the financial reporting period is provided in charity care to its residents, in community benefits, or in both. The percentage of the retirement facility's assessed value that is excluded from taxation is the applicable percentage provided in the following table, based on the minimum percentage of the facility's resident revenue that it provides in charity care to its residents, in community benefits, or in both.

Partial Exclusion	Minimum Percentage of Resident Revenue
80%	4%
60%	3%
40%	2%
20%	1%

(e) Application for exclusion. The application requirements of G.S. 105-282.1. apply to this section."

Section 2. Subsection (e) of Section 29.18 of S.L. 1998-212, as amended by S.L. 2000-20, 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. ~~G.S. 105-278.6A is repealed effective for taxes imposed for taxable years beginning on or after July 1, 2001.~~ The remainder of this section is effective when it becomes law."

Section 3. This act is effective for taxes imposed for taxable years beginning on or after July 1, 2001. Notwithstanding the provisions of G.S. 105-282.1(a), an application for the benefit provided in this act for the 2001-2002 tax year is timely if it is filed on or before September 1, 2001.

LEGISLATIVE PROPOSAL 1: Retirement Home Tax Change

BILL ANALYSIS

Committee: Revenue Laws
Date: October 16, 2000
Version: 2001-LAX-005

Introduced by:
Summary by: Martha K. Walston
Committee Counsel

SUMMARY: ***This draft provides a property tax exclusion for certain qualified retirement facilities that provide charity care and/or community benefits. The percentage of the exclusion depends upon the percentage of the facility's resident revenue that is provided in charity care, in community benefits, or in both. The draft is a compromise reached by a subcommittee composed of representatives from the CCRCs, the NC Department of Revenue, the NC Association of County Commissioners, and the NC Tax Assessors and Collectors.***

CURRENT LAW: Under G.S. 105-278.6, property owned by a nonprofit home for the aged, sick or infirm is exempt from property tax if used for a charitable purpose. 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." G.S. 105-278.6A allows a property tax exclusion to certain nonprofit continuing care retirement communities (CCRCs) that do not meet the definition of "charitable purpose", but do meet all of the following conditions:

1. The facility 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. The community's grounds and buildings must be at a single site.
2. The facility must be nonprofit and exempt from income tax, and its assets upon dissolution must revert to a 501(c)(3) charitable organization.
3. The facility must have an active fund-raising program to assist it in providing services to those who do not have the financial resources to pay fees.
4. The governing body of the facility must be selected by a charitable nonprofit that is exempt under section 501(c)(3) of the Internal Revenue Code and is a publicly supported charity. (A publicly supported charity is not a private foundation under section 509 of the Code.)

This property tax exclusion for the CCRCs, in G.S. 105-278.6A, sunsets on July 1, 2001. In the last session, the General Assembly extended the sunset from July 1, 2000 to July 1, 2001 in order to give representatives from the CCRCs, the NC Department of Revenue, the NC Association of County Commissioners, and the NC Tax Assessors and Collectors time to review the tax status of the CCRCs and to seek a compromise.

BILL ANALYSIS: This draft is a compromise reached by a subcommittee made up of representatives from the CCRCs, the Department of Revenue, the Association of County Commissioners, and the NC Tax Assessors and Collectors. This subcommittee has met approximately ten times. The draft repeals the

sunset for CCRCs and creates a permanent, complete or partial exclusion for CCRCs that provide minimum amounts of charity care and/or community benefits.

Section 1 of the draft bill does the following:

(a) Adds language to subsection (a) that is identical to the language in the statutes allowing property tax exemptions for property used for educational purposes and property used for religious educational purposes. This language exempts the buildings, the land they actually occupy, and additional land reasonably necessary for the convenient use of these buildings if the buildings and land meet certain conditions.

(b) Adds several new definitions to the statute. The new definitions define charity care, community benefits, financial reporting period, resident revenue, and unreimbursed costs. This section also amends the current definition for "retirement facility" in two ways:

> (1) It deletes the condition that the facility's grounds and buildings be at a single site. This change would allow a CCRC to expand without having to purchase contiguous land.
>
> (2) It adds the requirement that the facility be licensed as a continuing care retirement community by the Department of Insurance. A licensed facility must provide a contract for continuing care that sets out such provisions as the total consideration to be paid and the services to be provided. The licensed facility must also give each prospective resident a detailed disclosure statement, and must maintain operating reserves equal to 50% of the total operating costs projected for the 12-month period following the period covered by the most recent annual statement filed with the Department of Insurance. The Department defines "continuing care" as:
>
> > the furnishing to an individual other than an individual related by blood, marriage, or adoption to the person furnishing the care, of lodging together with nursing services, medical services, or other health related services, under an agreement effective for the life of the individual or for a period longer than one year.

(c) Allows a total property tax exclusion for a retirement facility that satisfies all of the following conditions:

- It meets the new definition of a retirement facility set out in subsection (b) of the draft.
- It meets the current conditions for a retirement facility, except that the facility's governing board does not have to be selected by a charitable nonprofit that is exempt under section 501(c)(3) of the Code.
- It either (a) serves all residents without regard to the residents' ability to pay, or (b) provides at least 5% of the facility's resident revenue for the financial reporting period in charity care to its residents, in community benefits, or in both. The financial reporting period is the calendar year or tax year ending prior to the date the retirement facility applies for exclusion under this section. This is the same reporting period covered in Form 990. The Internal Revenue Code requires 501(c) organizations to file 990s in order to receive tax-exempt status.

(d) Allows a partial property tax exclusion for a retirement facility that satisfies all of the following conditions:

- It meets the new definition of a retirement facility set out in subsection (b) of the draft.
- It meets the current conditions of a retirement facility, except that the facility's governing board does not have to be selected by a charitable nonprofit that is exempt under 501(c)(3) of the Code.
- It provides at least 1% of its resident revenue in charity care to its residents, in community benefits, or in both.

The partial exclusion is 80% of the assessed value if the facility provides a minimum of 4% of the facility's resident revenue in charity care and community benefits reduced to a 20% exclusion if the facility provides a minimum of 1% of the facility's resident revenue in charity care and community benefits.

(e) Clarifies that the owner of the facility must file annually for the property tax exclusion as required by G.S. 105-282.1. Under this statute, the application must contain the facts that entitle the owner to the exclusion.

Section 2 of the draft bill amends the 2000 Session Laws by deleting the sunset language for G.S. 105-278.6A.

Section 3 of the draft bill sets out the effective date.

FISCAL ANALYSIS MEMORANDUM

DATE: October 13, 2000

TO: Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Legislative Proposal 1
Continuing Care Retirement Communities

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund	**No General Fund Impact**				
Local Governments	**1.7 – 2.5 Million Minimum**				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue, Local Governments.

EFFECTIVE DATE: Effective for taxes imposed for taxable years beginning on or after July 1, 2001.

BILL SUMMARY: The bill provides a property tax exemption for certain non-profit continuing care retirement communities (CCRC). To qualify for a full exemption the CCRC must meet the following criteria:

1). Be a 501(C)3 organization,
2). Be designed for elderly residents,
3). Include independent living units for the elderly,
4). Provide a skilled nursing or adult care facility,
5). Be licensed by the Department of Insurance as a CCRC, and
6). Either:

A). Have unreimbursed costs (charity care, Medicare and Medicaid gap) of providing health care, housing, or other services for residents unable to pay for all or part of the services, and unreimbursed costs of providing "community benefits" that exceed 5% of the total resident revenue, **OR**

B). Serve all residents without regard to their ability to pay.

CCRCs can also receive a partial exemption if they meet the requirements of 1 – 5 above but have a lower charity care and community benefit to resident revenue ratio between 1% and 5%. If that ratio is greater than 4% the CCRC would qualify be able to exempt 80% of the value of their property. If the ratio is greater than 3%, then 60% could be exempt. If the ratio is greater than 2% a 40% exemption could apply. If the ratio is more than 1% a 20% exemption is possible. Community benefits are defined as the unreimbursed cost to the facility of providing charitable donations, donated volunteer services, donations and voluntary payments to government agencies, and services, including health, recreation, community research, and educational activities. These services can be provided to the community at large, including the elderly population.

ASSUMPTIONS AND METHODOLOGY: As of October 1999 the Department of Insurance reported that there are 48 Continuing Care Retirement Communities (CCRC) in North Carolina. Forty-two (42) of these facilities are non-profit institutions.

In the spring and summer of 2000 the North Carolina Association of Non-profit Homes for the Aging (NCANPHA) surveyed all 48 CCRCs to determine the amount of charity care provided by their member organizations. Thirty-two of the non-profit facilities or 76% provided at least some charity data. In this survey, and under the legislation, charity care is defined as the unreimbursed cost of services provided to residents, including the gap between what Medicare and Medicaid pays and the documented cost of the service. This survey revealed that 12 of the 32 non-profit facilities (38%) reported a charity care cost gap to annual resident revenue ratio of 5% or more. With the legislation these facilities will qualify for a total exemption from property taxes for their facility. The charity care cost gap, as well as the value and the tax loss reported by county assessors is as follows:

Facility Name	Resident Revenue	Cost Gap	Cost to Revenue Ratio	Value	Tax Loss
Buncombe County					
Givens Estates	6,576,152	671,295	10.21%	7,117,500	44,840
Chatham County					
*Pittsboro Christian Village**	1,220,021	85,243	6.99%	3,616,506	20,368
Forsyth County					
Arbor Acres	9,912,940	700,646	7.07%	27,553,080	182,539
Brookridge	6,277,762	1,150,000	18.32%	16,419,000	108,776
*Moravian Home**	6,831,395	594,725	8.71%	13,608,900	84,798
Guilford County					
Masonic & Eastern Star	1,451,200	2,486,564	171.35%	14,127,900	90,023
*Pres. Home of High Point**	6,938,315	594,023	8.56%	2,015,500	530
Mecklenburg County					
Aldersgate	10,883,159	1,291,982	11.87%	50,692,340	370,054
Carmel Hills	1,026,802	76,958	7.49%	4,554,590	33,249
Sharon Towers	8,497,627	946,690	11.14%	21,175,880	154,584
Robeson County					
Wesley Pines	3,678,205	363,905	9.89%	4,579,246	37,092

Scotland County					
Scotia Village	4,798,963	332,172	6.92%	15,229,940	141,638
TOTAL	**68,092,541**	**9,294,203**	**23%**	**180,690,382**	**1,268,491**

Please note that in some cases (those noted with an *) the facility may qualify for a partial exemption under another statute. As such the numbers shown above are the net change.

The bill also grants a particle exemption from property tax for CCRCs that provide between 1% and 5% of their annual resident revenue in charity care and community benefits. Under the legislation a facility that has a charity and community benefit to resident revenue ratio of 4% or more qualifies for a 80% property tax exemption, while a CCRC with a 3% ratio qualifies for a 60% exemption, a facility with a 2% ratio qualifies for a 40% exemption and a facility with a 1% ratio qualifies for a 20% exemption.

According to the NCANPHA survey, ten of the thirty-three responding facilities (30%) will qualify for a partial exemption. The resident revenue, cost gap, cost to revenue ratio, and the percent exemption for each facility is listed below.

Facility Name	Resident Revenue	Cost Gap	Cost to Revenue Ratio	Exemption
Alamance County				
Twin Lakes Center	$10,000,000	$393,192	3.93%	60%
Catawba County				
Abernethy Center	$18,094,504	$555,211	3.07%	60%
Durham County				
Croasdaile Village (new UMC)	$503,996	$15,000	2.98%	40%
Gaston County				
Covenant Village	$5,667,271	$59,154	1.04%	20%
Guilford County				
Friends Homes	$12,848,514	$272,585	2.12%	40%
Henderson County				
Carolina Village	$4,841,130	$180,800	3.73%	60%
Mecklenburg County				
Southminster	$8,882,000	$301,000	3.39%	60%
Moore County				
Quail Haven	$3,460,771	$36,316	1.05%	20%
Orange County				
Carol Woods	$12,590,755	$125,444	1.00%	20%
Wake County				
Glenaire	$6,725,687	$95,699	1.42%	20%
Total	**$ 83,614,628**	**$ 2,034,401**	**2.37%**	40%

The property tax loss from these partial exemptions is as follows:

Facility Name	Value	Potential Tax Liability	New Tax Liability	Tax Loss
Alamance County				

Twin Lakes Center	19,635,180	$103,085	$41,234	$61,851
Catawba County				
Abernethy Center	8,245,000	$40,813	$16,325	$24,488
Durham County				
Croasdaile Village (new UMC)	2,950,344	$27,429	$16,458	$10,972
Gaston County				
Covenant Village	16,368,200	$135,038	$108,030	$27,008
Guilford County				
Friends Homes	19,886,900	$126,719	$76,032	$50,688
Henderson County				
Carolina Village	18,552,800	$92,764	$37,106	$55,658
Mecklenburg County				
Southminster	33,220,700	$242,511	$97,004	$145,507
Moore County				
Quail Haven	5,875,654	$28,790.70	$23,033	$5,758
Orange County				
*Carol Woods***	N/A	N/A	N/A	N/A
Wake County				
Glenaire	31,237,964	$228,037	$182,430	$45,607
Total	**183,651,342**	**1,279,553**	**801,144**	**427,536**

Please note that the facility marked with an ** has not applied for a property tax exemption although they appear to qualify under the temporary exemption. NCANPHA reports that the board voluntarily decided to pay the tax, and that the organization plans to continue to pay tax. As such the bill will have no impact on their behavior, although they would qualify for a particle exemption.

The North Carolina Department of Insurance reports that five (5) additional CCRCs are expected to be in operation in the next five years. Three (3) of these facilities are non-profit and could qualify for the exemption if they provided enough charity care and community benefit. The total expected value and potential tax losses, by county, are as follows:

Facility	**Value**	**Potential Tax Loss**
Alamance County		
Village at Brookwood	64,000,000	336,000
Cabarrus County		
Taylor Glen	25,000,000	140,000
Guilford County		
Riverlanding	51,000,000	324,972

Given the losses and potential losses listed above, the county loss ranges are as follows:

County	**Tax Loss**
Alamance	61,851 - 397,851
Buncombe	89,680
Cabarrus	0 - 140,000
Catawba	24,488

Chatham	20,368
Durham	10,972
Forsyth	376,113
Gaston	27,008
Guilford	141,241 - 466,213
Henderson	55,658
Mecklenburg	703,394
Moore	5,758
Robeson	37,092
Scotland	141,638
Wake	45,607
Total	1,696,028 - 2,497,00

While this estimate is based on the best data available Fiscal Research believes the actual cost of the exemptions could be higher for four reasons. First, some of the CCRCs that did not provide data might actual qualify for an exemption. Second, facilities that are near a break point may marginally increase their charitable or community activity to qualify for the higher exemption. Third, while the survey reports charity care numbers it does not reveal the cost CCRCs attribute to "community benefits". While the NCANPHA states that these "community benefit" numbers will be relatively low the exact amount is unclear to Fiscal Research. Finally, because these number represent only the cost to counties and not municipalities the total local cost will be higher. As a result of these factors, the range listed about is actually a minimum estimate.

Note: While most local governments will see a revenue increase from 1999-00 to 2001-02 as a result of this bill, the change is actually shown as a loss to local governments. This is because the temporary exemption that shelters non-profit CCRCs from sales tax is scheduled to expire July 1, 2001. The annual cost to counties of the temporary exemption was estimated in 1998 to be approximately $5.1 million. Thus the counties overall should see a revenue gain from 2000 of approximately $2.6 - $3.4 million. The exact impact will vary by county.

LEGISLATIVE PROPOSAL #2

PROPERTY TAX HOMESTEAD EXCLUSION

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 2:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO PROVIDE PROPERTY TAX RELIEF TO LOW-INCOME ELDERLY AND DISABLED HOMEOWNERS

SHORT TITLE: Property Tax Homestead Exclusion.

BRIEF OVERVIEW: The proposal expands the homestead exclusion amount from $20,000 to the greater of $20,000 or 50% of the tax value of the property. It also increases the income eligibility amount of $15,000 by a percentage equal to the COLA percentage used to increase social security benefits for the preceding calendar year.

FISCAL IMPACT: The proposal does not impact the State General Fund. It is expected to decrease local government property tax revenues by $25 million to $35 million annually.

EFFECTIVE DATE: The proposal is effective for property taxes imposed for taxable years beginning on or after July 1, 2002.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

LEGISLATIVE PROPOSAL 2
01-RBZ-2(1.15)
THIS IS A DRAFT 22-JAN-01 17:05:09

Short Title: Property Tax Homestead Exclusion. (Public)

Sponsors:

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO PROVIDE PROPERTY TAX RELIEF TO LOW-INCOME ELDERLY AND
3 DISABLED HOMEOWNERS.
4 The General Assembly of North Carolina enacts:
5 Section 1. G.S. 105-277.1 reads as rewritten:
6 "**§ 105-277.1. Property classified for taxation at reduced**
7 **valuation.**
8 (a) Exclusion. -- ~~The following class of property~~ A permanent
9 residence owned and occupied by a qualifying owner is designated
10 a special class of property under Article V, Sec. 2(2) of the
11 North Carolina Constitution and ~~shall be assessed for taxation in~~
12 ~~accordance with this section. The first twenty thousand dollars~~
13 ~~($20,000) in appraised value of a permanent residence owned and~~
14 ~~occupied by a qualifying owner is excluded from taxation.~~ is
15 taxable in accordance with this section. The amount of the
16 appraised value of the residence equal to the exclusion amount is
17 excluded from taxation. The exclusion amount is the greater of
18 twenty thousand dollars ($20,000) or fifty percent (50%) of the
19 appraised value of the residence. A qualifying owner is an owner
20 who meets all of the following requirements as of January 1
21 preceding the taxable year for which the benefit is claimed:
22 (1) Is at least 65 years of age or totally and
23 permanently disabled.

(2) Has an income for the preceding calendar year of not more than ~~fifteen thousand dollars ($15,000).~~ the income eligibility limit.

(3) Is a North Carolina resident.

(a1) Temporary Absence. -- An otherwise qualifying owner does not lose the benefit of this exclusion because of a temporary absence from his or her permanent residence for reasons of health, or because of an extended absence while confined to a rest home or nursing home, so long as the residence is unoccupied or occupied by the owner's spouse or other dependent.

(a2) Income Eligibility Limit. -- Until July 1, 2002, the income eligibility limit is fifteen thousand dollars ($15,000). For taxable years beginning on or after July 1, 2002, the income eligibility limit is the amount for the preceding year, adjusted by the same percentage of this amount as the percentage of any cost-of-living adjustment made to the benefits under Titles II and XVI of the Social Security Act for the preceding calendar year, rounded to the nearest one hundred dollars ($100.00). On or before July 1 of each year, the Department of Revenue must determine the income eligibility amount to be in effect for the taxable year beginning the following July 1 and must notify the assessor of each county of the amount to be in effect for that taxable year.

(b) Definitions. -- When used in this section, the following definitions shall apply:

(1) Code. -- The Internal Revenue Code, as defined in G.S. 105-228.90.

(1a) Income. -- Adjusted gross income, as defined in section 62 of the Code, plus all other moneys received from every source other than gifts or inheritances received from a spouse, lineal ancestor, or lineal descendant. For married applicants residing with their spouses, the income of both spouses must be included, whether or not the property is in both names.

(1b) Owner. -- A person who holds legal or equitable title, whether individually, as a tenant by the entirety, a joint tenant, or a tenant in common, or as the holder of a life estate or an estate for the life of another. A manufactured home jointly owned by husband and wife is considered property held by the entirety.

(2) Repealed by Session Laws 1993, c. 360, s. 1.

1 (2a) Repealed by Session Laws 1985 (Reg. Sess., 1986),
2 c. 982, s. 20.
3 (3) Permanent residence. -- A person's legal residence.
4 It includes the dwelling, the dwelling site, not to
5 exceed one acre, and related improvements. The
6 dwelling may be a single family residence, a unit
7 in a multi-family residential complex, or a
8 manufactured home.
9 (4) Totally and permanently disabled. -- A person is
10 totally and permanently disabled if the person has
11 a physical or mental impairment that substantially
12 precludes him or her from obtaining gainful
13 employment and appears reasonably certain to
14 continue without substantial improvement throughout
15 his or her life.
16 (c) Application. -- An application for the exclusion provided
17 by this section should be filed during the regular listing
18 period, but may be filed and must be accepted at any time up to
19 and through April 15 preceding the tax year for which the
20 exclusion is claimed. When property is owned by two or more
21 persons other than husband and wife and one or more of them
22 qualifies for this exclusion, each owner shall apply separately
23 for his or her proportionate share of the exclusion.
24 (1) Elderly Applicants. -- Persons 65 years of age or
25 older may apply for this exclusion by entering the
26 appropriate information on a form made available by
27 the assessor under G.S. 105-282.1.
28 (2) Disabled Applicants. -- Persons who are totally and
29 permanently disabled may apply for this exclusion
30 by (i) entering the appropriate information on a
31 form made available by the assessor under G.S. 105-
32 282.1 and (ii) furnishing acceptable proof of their
33 disability. The proof shall be in the form of a
34 certificate from a physician licensed to practice
35 medicine in North Carolina or from a governmental
36 agency authorized to determine qualification for
37 disability benefits. After a disabled applicant has
38 qualified for this classification, he or she shall
39 not be required to furnish an additional
40 certificate unless the applicant's disability is
41 reduced to the extent that the applicant could no
42 longer be certified for the taxation at reduced
43 valuation.

(d) Multiple Ownership. -- A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of this exclusion notwithstanding that only one of them meets the age or disability requirements of this section. When a permanent residence is owned and occupied by two or more persons other than husband and wife and one or more of the owners qualifies for this exclusion, each qualifying owner is entitled to the full amount of the exclusion not to exceed his or her proportionate share of the valuation of the property. No part of an exclusion available to one co-owner may be claimed by any other co-owner and in no event may the total exclusion allowed for a permanent residence exceed the exclusion amount provided in this section."

Section 2. G.S. 105-309(f) reads as rewritten:

"(f) The following information shall appear on each abstract or on an information sheet distributed with the abstract. The abstract or sheet must include the address and telephone number of the assessor below the notice required by this subsection. The notice shall read as follows:

'PROPERTY TAX ~~RELIEF~~ HOMESTEAD EXCLUSION FOR ELDERLY AND PERMANENTLY DISABLED PERSONS.

North Carolina excludes from property taxes ~~the first twenty thousand dollars ($20,000) in~~ a portion of the appraised value of a permanent residence owned and occupied by North Carolina residents aged 65 or older or totally and permanently disabled whose income does not exceed ~~fifteen thousand dollars ($15,000).~~ (assessor insert amount). The amount of the appraised value of the residence that may be excluded from taxation is the greater of twenty thousand dollars ($20,000) or fifty percent (50%) of the appraised value of the residence. Income means the owner's adjusted gross income as determined for federal income tax purposes, plus all moneys received other than gifts or inheritances received from a spouse, lineal ancestor or lineal descendant.

If you received this exclusion in (assessor insert previous year), you do not need to apply again unless you have changed your permanent residence. If you received the exclusion in (assessor insert previous year) and your income in (assessor insert previous year) was above ~~fifteen thousand dollars ($15,000),~~ (assessor insert amount), you must notify the assessor. If you received the exclusion in (assessor insert previous year) because you were totally and permanently disabled

1 and you are no longer totally and permanently disabled, you must
2 notify the assessor. If the person receiving the exclusion in
3 (assessor insert previous year) has died, the person required by
4 law to list the property must notify the assessor. Failure to
5 make any of the notices required by this paragraph before April
6 15 will result in penalties and interest.
7 If you did not receive the exclusion in (assessor insert
8 previous year) but are now eligible, you may obtain a copy of an
9 application from the assessor. It must be filed by April 15.'"
10 Section 3. This act is effective for taxes imposed for
11 taxable years beginning on or after July 1, 2002.

BILL ANALYSIS

LEGISLATIVE PROPOSAL 2: Property Tax Homestead Exclusion

Committee:	Revenue Laws	**Introduced by:**	
Date:	January 16, 2001	**Summary by:**	Cindy Avrette
Version:	01-RBZ-2(1.15)		Committee Counsel

***SUMMARY:** Legislative Proposal 2 expands the homestead exclusion amount from $20,000 to the greater of $20,000 or 50% of the tax value of the property. It also increases the income eligibility amount of $15,000 by a percentage equal to the COLA percentage used to increase social security benefits for the preceding calendar year. The proposal becomes effective for taxes imposed for taxable years beginning on or after July 1, 2002.*

CURRENT LAW: The homestead exclusion is a partial exclusion from property taxes for the residence of a person who is either aged 65 or older or totally disabled and has an income of less than $15,000. The current exclusion amount is $20,000. The exclusion amount was last increased in 1996, when it was increased from $15,000 to $20,000. The income eligibility amount was last increased in 1996, when it was increased from $11,000 to $15,000. The income used to determine the income eligibility amount includes moneys received from every source other than gift or inheritances received from a spouse, lineal ancestor, or lineal descendant. For married applicants residing with their spouses, the income of both spouses is included, whether or not the property is in both names.

Prior to 1987, local government absorbed most of the cost of the homestead exclusion. From 1987 to 1991, the State reimbursed counties and cities for 50% of their losses from the homestead exclusion. In 1991, the General Assembly froze the amount of reimbursements made to local governments to the amount each city and county was entitled to receive in 1991. That amount is approximately $7.9 million. No additional reimbursement was provided when the exclusion amount was increased in 1993. The State reimbursed counties and cities for 50% of the loss they incurred for two years when the exclusion amount and the income eligibility amount were increased in 1996.

BILL ANALYSIS: Legislative Proposal 2 would increase the homestead exclusion amount for eligible property owners whose homes are appraised at a value greater than $40,000. The proposal would provide that the homestead exclusion amount is the greater of $20,000 or 50% of the tax value of the home. Effective for property tax years beginning on or after July 1, 2002, the proposal would also index the income eligibility amount of$15,000 by a percentage equal to the cost-of-living adjustment percentage used to increase social security benefits for the preceding calendar year. The automatic COLAs for social security benefits are announced in October of each year. The COLAs are based o increased in the CPI for Urban Wage Earners and Clerical Workers from the third quarter of ht prior year to the corresponding quarter of the current year in which the COLA became effective. The COLA for 2000 is 3.5%.

FISCAL ANALYSIS MEMORANDUM

DATE: **January 18, 2000**

TO: Revenue Laws Study Committee

FROM: Eugene Son and Linda Millsaps
Fiscal Research Division

RE: Legislative Proposal 2
Property Tax Homestead Exemption

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
State Government	No General Fund Impact				
Local Governments	0	$9.65 million to $21.15 million annual revenue loss			

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

EFFECTIVE DATE: Effective for taxes imposed for taxable years beginning on or after July 1, 2002.

BILL SUMMARY: The legislation adjusts the basis for determining the exemption amount of the homestead exemption from property tax, and allows for an annual adjustment of income eligibility by the federally defined Cost of Living Adjustment (COLA). Currently the income eligibility level is $15,000 with $20,000 of property value exempted for those who qualify. The bill maintains the $15,000 income threshold for FY 2001-02, but increases this limit by the COLA multiplier used to increase SSI benefits for subsequent years. The bill also maintains $20,000 as the minimum homestead exclusion, but allows for an exclusion of 50% of the tax value if the property value is greater than $20,000.

Background Information: The homestead exemption is a partial exemption from property taxes for the residence of a person who is aged 65 or older, or totally disabled, and who has an income of less than $15,000. The income threshold essentially counts income from all sources. The legislation has been amended eight times since 1972 in an effort to adjust the eligibility and

exemption amounts for increases in the assessed value of housing and income levels. The exemption amount was last increased in 1996, when it was raised from $15,000 to $20,000 effective July 1, 1997. At the same time, the income eligibility amount was last increased from $11,000 to $15,000. Below is a chart outlining the changes to income eligibility and exemption levels since 1972.

Year	Income Eligibility	Property Exemption
1972	$ 3,500	$ 5,000
1973	$ 5,000	$ 5,000
1975	$ 7,500	$ 5,000
1977	$ 9,000	$ 7,500
1981	$ 9,000	$ 8,500
1985	$ 10,000	$ 10,000
1986	$ 11,000	$ 12,000
1993	$ 11,000	$ 15,000
1996	$ 15,000	$ 20,000

The current annual total cost of the homestead exemption program is approximately $27.0 million. Of this total, $19.1 million is borne by local governments, while the remaining $7.9 million is funded by the state. When the homestead provision was enacted in 1972 and expanded in the 1970's, there was no reimbursement to counties and cities. In 1982 the state began to reimburse local governments for all of the expansion costs. The end result of the 1970's policy and that of the 1980's was that by 1991 there was mathematically an equal split between the state and local cost responsibility ($7.9 million for each, for a total of $15.8 million).

When the exemption was raised in 1993, local units absorbed all of the $5.2 million cost increase. In 1996 the state granted a 50% reimbursement to local governments for costs associated with the changes made by the law during that year. That increased the reimbursements to local governments by approximately $3 million, to $10.9 million out of a $27.0 million total. The $3.0 million increase sunset in May of 1999, and the city and county reimbursement level returned to $7.9 million (50% of 1991 costs).

ASSUMPTIONS AND METHODOLOGY:

Under the current system, as the tax assessed value of the residence increases, the exemption for qualified residents remains at $20,000 regardless value. Under the proposed legislation, if 50% of the tax assessed value of the property is greater than $20,000, the qualified resident would be allowed the greater of the exclusions. As a result, the bill increases the relief granted to low-income elderly and disabled homeowners residing in homes with property values greater than $40,000.

The proposed legislation maintains the current income eligibility requirement for FY 01-02, but increases this threshold annually by the amount of the COLA as determined by the Social Security Administration in subsequent years.

The additional estimated property tax revenue loss to local governments from the legislation is $9.65 million to $21.15 million dollars annually. This estimate is generated using two principal data sources. The first source is a North Carolina Association of Assessing Officers study of the 1999 homestead exemption statistics and projected revenue losses for forty representative counties if the bill becomes law. The second source is the 1997 statewide summary of homestead exemption statistics provided by the Department of Revenue Property Tax Division. The ratio of the total number of exclusions for the forty representative counties to the total number of statewide exclusions was first established in order to determine the relationship between the sample and the entire state. This relationship was then used to transfer the estimate of the proposed revenue loss for the forty counties into a revenue loss projection for the entire state. This resulted in a revenue loss estimate of approximately $25 million. The ratio of the total value of homestead exclusions for the sample to the value of exclusions for the entire state was utilized in a similar fashion to produce a revenue loss estimate of approximately $35 million. Therefore, preliminary estimated revenue loss to all counties in the state is from $25 million to $35 million dollars.

There is a disproportionately high percentage elderly households that fall within the $15,000 to $25,000 income range outlined in the chart below. The large number of households that fall within this range can be attributed to the great number of residents who draw the maximum social security payment, or the maximum amount plus a pension. The current maximum SSI payment is $1,433 monthly, or $17,196 per year. , If the bill becomes law, the current $15,000 income eligibility threshold will be adjusted by the COLA after FY 01-02, and many more elderly and disabled citizens in this income range will qualify for the homestead property tax exclusion. Therefore the preliminary estimate has been increased by 15%, to suggest an annual revenue loss of $28.75 to $40.25 million. Since local governments currently bear $19.1 million in revenue loss due to the homestead exclusion, the additional revenue loss due to this legislation is between $9.65 to $21.15 million.

1998 National Income Distribution of Elderly Households

	Actual	Percent
Less than $5,000	702,000	3.28%
$5000 to $9,999	3,777,000	17.64%
$10,000 to $14,999	3,614,000	16.88%
$15,000 to $24,999	5,016,000	**23.43%**
$25,000 to $34,999	2,952,000	**13.79%**
$35,000 to $49,999	2,334,000	10.90%
$50,000 to $74,999	1,614,000	7.54%
$75,000 to $99,999	686,000	3.20%
$100,000 and over	714,000	3.34%
Total	21,409,000	100%

Given the limitations of the estimation methodology, only upon the completion of the detailed year 2000 census data will truly reliable estimates be available.

LEGISLATIVE PROPOSAL #3

PROPERTY TAX AMENDMENTS

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 3:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO AMEND VARIOUS PROPERTY TAX LAWS.

SHORT TITLE: Property Tax Amendments.

BRIEF OVERVIEW: This proposal makes several changes to the property tax laws recommended by the Department of Revenue, the Institute of Government, and the North Carolina Association of Assessing Officers.

- It clarifies the application process for property tax exemptions and exclusions.
- It gives the assessor the authority to remove a property's preferential tax classification if the taxpayer does not provide the assessor with the information requested to verify the property's qualifications for the preferential tax classification.
- It gives all boards of equalization and review the authority to meet after their adjournment date to hear use value, exempt property, discoveries, and motor vehicle valuation cases.
- It clarifies the changes allowed in a non-reappraisal year.
- It shortens the waiting period for en rem foreclosures.
- It conforms the interest rate on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes.

FISCAL IMPACT: The proposal does not impact the State General Fund. It has an insignificant impact on local government revenues.

A copy of the proposed legislation, explanation, and fiscal note begin on page 38

EFFECTIVE DATE: Except as provided below, the proposal is effective when it becomes law:

- The provision clarifying what changes are allowed in a non-appraisal year becomes effective for taxes imposed for taxable years beginning on or after July 1, 2002.
- The provision conforming the interest rate on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes becomes effective for taxes imposed for taxable years beginning on or after July 1, 2001.
- The provision shortening the waiting period for en rem foreclosures becomes effective July 1, 2001, and applies to en rem foreclosure proceedings begun on or after that date.

A copy of the proposed legislation, explanation, and fiscal note begin on page 38

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

01-RBXZ-302
THIS IS A DRAFT 23-JAN-01 08:55:25

Short Title: Property Tax Amendments. (Public)

Sponsors:

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO AMEND VARIOUS PROPERTY TAX LAWS.
3 The General Assembly of North Carolina enacts:
4 Section 1. G.S. 105-282.1 reads as rewritten:
5 "**§ 105-282.1. Applications for property tax exemption or**
6 **~~exclusion.~~ exclusion; annual review of property exempted or**
7 **excluded from property tax.**
8 (a) Application. -- Every owner of property claiming
9 exemption or exclusion from property taxes under the provisions
10 of this Subchapter has the burden of establishing that the
11 property is entitled ~~thereto. Except as provided below, an owner~~
12 ~~claiming exemption or exclusion shall annually file an~~
13 ~~application for exemption or exclusion during the listing period.~~
14 to it. If the property for which the exemption or exclusion is
15 claimed is appraised by the Department of Revenue, the
16 application shall be filed with the Department. Otherwise, the
17 application shall be filed with the assessor of the county in
18 which the property is situated. An application must contain a
19 complete and accurate statement of the facts that entitle the
20 property to the exemption or exclusion and must indicate the
21 municipality, if any, in which the property is located. Each
22 application filed with the Department of Revenue or an assessor
23 shall be submitted on a form approved by the Department.

Application forms shall be made available by the assessor and the Department, as appropriate.

~~(1) The United States government, the State of North Carolina and the counties and municipalities of the State are exempted from the requirement that owners file applications for exemption.~~

~~(2) Owners of the special classes of property excluded from taxation under G.S. 105-275(5), (15), (16), (26), (31), (32a), (33), (34), or (40), or exempted under G.S. 105-278.2 are not required to file applications for the exclusion or exemption of that property.~~

~~(3) After an owner of property entitled to exemption under G.S. 105-278.3, 105-278.4, 105-278.5, 105-278.6, 105-278.7, or 105-278.8 or exclusion under G.S. 105-275(3), (7), (8), (12), (17) through (19), (21) or (39), G.S. 105-277.1, or G.S. 105-278 has applied for exemption or exclusion and the exemption or exclusion has been approved, the owner is not required to file an application in subsequent years except in the following circumstances:~~

~~a. New or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property; or~~

~~b. There is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the exemption or exclusion.~~

~~(4) After an owner of property entitled to exclusion under G.S. 105-277.10 has applied for the exclusion and the exclusion has been approved, the owner is not required to apply for the exclusion in subsequent years so long as the classified property, including classified property acquired after the application is approved, is used or held for use directly in manufacturing or processing as part of industrial machinery.~~

~~(5) Upon a showing of good cause by the applicant for failure to make a timely application, an application for exemption or exclusion filed after the close of the listing period may be approved by the Department of Revenue, the board of~~

~~equalization and review, the board of county commissioners, or the governing body of a municipality, as appropriate. An untimely application for exemption or exclusion approved under this subdivision applies only to property taxes levied by the county or municipality in the calendar year in which the untimely application is filed.~~

Except as provided below, an owner claiming an exemption or exclusion from property taxes must file an application for the exemption or exclusion annually during the listing period.

(1) No application required. -- Owners of the following exempt or excluded property do not need to file an application for the exemption or exclusion to be entitled to receive it.
  a. Property exempt from taxation under G.S. 105-278.1 or G.S. 105-278.2.
  b. Special classes of property excluded from taxation under G.S. 105-275(15), (16), (26), (31), (32a), (33), (34), (37), (40), or (42).
  c. Property classified for taxation at a reduced valuation under G.S. 105-277(g) or G.S. 105-277.9.

(2) Single application required -- An owner of one or more of the following properties eligible to be exempted or excluded from taxation must file an application for exemption or exclusion to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the exemption or exclusion.
  a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 15-278.5, 105-278.6, 105-278.7, or 105-278.8.
  b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (35), (36), (38), (39), or (41).

1 c. Special classes of property classified
2 for taxation at a reduced valuation under
3 G.S. 105-277(h), 105-277.1, 105-277.10,
4 105-277.13, or 105-278.
5 d. Property owned by a nonprofit homeowners'
6 association but where the value of the
7 property is included in the appraisals of
8 property owned by members of the
9 association under G.S. 105-277.8.
10 (a1) Late Application. -- Upon a showing of good cause by the
11 applicant for failure to make a timely application, an
12 application for exemption or exclusion filed after the close of
13 the listing period may be approved by the Department of Revenue,
14 the board of equalization and review, the board of county
15 commissioners, or the governing body of a municipality, as
16 appropriate. An untimely application for exemption or exclusion
17 approved under this subsection applies only to property taxes
18 levied by the county or municipality in the calendar year in
19 which the untimely application is filed.
20 (b) Approval and Appeal Process. -- The Department of Revenue
21 or the assessor to whom an application for exemption or exclusion
22 is submitted ~~shall~~ must review the application and either approve
23 or deny the application. Approved applications shall be filed and
24 made available to all taxing units in which the exempted or
25 excluded property is situated. If the Department denies an
26 application for exemption or exclusion, it shall notify the
27 taxpayer, who may appeal the denial to the Property Tax
28 Commission.
29 If an assessor denies an application for exemption or
30 exclusion, ~~he shall~~ the assessor must notify the owner of ~~his~~ the
31 decision ~~in time for him~~ and the owner may ~~to~~ appeal the decision
32 to the board of equalization and review or the board of county
33 commissioners, as appropriate, and from the county board to the
34 Property Tax Commission. If the notice of denial covers property
35 located within a municipality, the assessor shall send a copy of
36 the notice and a copy of the application to the governing body of
37 the municipality. The municipal governing body shall then advise
38 the owner whether it will adopt the decision of the county board
39 or require the owner to file a separate appeal with the municipal
40 governing body. In the event the owner is required to appeal to
41 the municipal governing body and that body renders an adverse
42 decision, the owner may appeal to the Property Tax Commission.
43 Nothing in this ~~section~~ subsection shall prevent the governing
44 body of a municipality from denying an application which has been

approved by the assessor or by the county board provided the owner's rights to notice and hearing are not abridged. Applications handled separately by a municipality shall be filed in the office of the person designated by the governing body, or in the absence of such designation, in the office of the chief fiscal officer of the municipality.

(c) Discovery of Property. -- When an owner of property that may be eligible for exemption or exclusion neither lists the property nor files an application for exemption or exclusion, the assessor or the Department of Revenue, as appropriate, shall proceed to discover the property. If, upon appeal, the owner demonstrates that the property meets the conditions for exemption or exclusion, the body hearing the appeal may approve the exemption or exclusion. Discovery of the property by the Department or the county shall automatically constitute a discovery by any taxing unit in which the property has a taxable situs.

(d) Roster of Exempted and Excluded Property. -- The ~~county~~ assessor shall prepare and maintain a roster of all property in the county that is granted tax relief through classification or exemption. On or before November 1 of each year, the assessor must send a report to the Department of Revenue summarizing the information contained in the roster. The report must be in the format required by the Department. The assessor must also send the Department a copy of the roster upon the request of the Department. As to affected real and personal property, the roster shall set forth:

(1) The name of the owner of the property.
(2) A brief description of the property.
(3) A statement of the use to which the property is put.
(4) A statement of the value of the property.
(5) The total value of exempt property in the county and in each municipality therein.

(e) Annual Review of Exempted or Excluded Property. -- Pursuant to G.S. 105-296(l), the assessor must annually review at least one-eighth of the parcels in the county exempted or excluded from taxation to verify that the parcels qualify for the exemption or exclusion. ~~A duplicate copy of the roster shall be forwarded to the Department of Revenue on or before November 1, 1974. In subsequent years, on or before November 1, a report shall be filed with the Department of Revenue showing all changes since the last report.~~"

Section 2. G.S. 105-287(a) reads as rewritten:

"(a) In a year in which a general reappraisal or horizontal adjustment of real property in the county is not made, the assessor shall increase or decrease the appraised value of real property, as determined under G.S. 105-286, ~~to accomplish any one or more of the following:~~ to recognize a change in the property's value resulting from one or more of the reasons listed in this subsection. The reason necessitating a change in the property's value need not be under the control of or at the request of the owner of the affected property.

(1) Correct a clerical or mathematical error.

(2) Correct an appraisal error resulting from a misapplication of the schedules, standards, and rules used in the county's most recent general reappraisal or horizontal adjustment.

(2a) Recognize an increase or decrease in the value of the property resulting from a conservation or preservation agreement subject to Article 4 of Chapter 121 of the General Statutes, the Conservation and Historic Preservation Agreements Act.

(2b) Recognize an increase or decrease in the value of the property resulting from a physical change to the land or to the improvements on the land, other than a change listed in subsection (b) of this section.

(2c) Recognize an increase or decrease in the value of the property resulting from a change in the legally permitted use of the property.

(3) Recognize an increase or decrease in the value of the property resulting from a factor other than one listed in subsection (b)."

Section 3. G.S. 105-296(j) reads as rewritten:

"(j) The assessor shall annually review one eighth of the parcels in the county classified for taxation at present-use value to verify that these parcels qualify for the classification. By this method, the assessor shall review the eligibility of all parcels classified for taxation at present-use value in an eight-year period. The assessor may require the owner of classified property to submit any information needed by the assessor to verify that the property continues to qualify for present-use value taxation. The assessor may require the owner of the classified property to submit any information needed by the assessor to verify that the property continues to qualify for present-use valuation. The owner has 30 days from the date a

1 written request for the information is made to submit the
2 information to the assessor. If the information is not made
3 available to the assessor in the time allowed, the property may
4 lose its present-use value classification and the property's
5 deferred taxes become due and payable as provided in G.S. 105-
6 277.4(c). The assessor must reinstate the property's present-use
7 value classification when the owner submits the requested
8 information unless the information discloses that the property no
9 longer qualifies for present-use value classification."
10 Section 4. G.S. 105-296(l) reads as rewritten:
11 "(l) The assessor shall annually review at least one-eighth of
12 the parcels in the county exempted or excluded from taxation to
13 verify that these parcels qualify for the exemption or exclusion.
14 By this method, the assessor shall review the eligibility of all
15 parcels exempted or excluded from taxation in an eight-year
16 period. The assessor may require the owner of exempt or excluded
17 property to make available for inspection any information
18 reasonably needed by the assessor to verify that the property
19 continues to qualify for the exemption or exclusion. The owner
20 has 30 days from the date a written request for the information
21 is made to make the information available for inspection. If the
22 information is not made available to the assessor in the time
23 allowed, the property may lose its exemption or exclusion. The
24 assessor must reinstate the property's exemption or exclusion
25 when the owner makes the requested infomration available unless
26 the information discloses that the property is no longer eligible
27 for the exemption or exclusion."
28 Section 5. G.S. 105-296 is amended by adding a new
29 subsection to read:
30 "(m) The assessor shall annually review the transportation
31 corridor official maps and and amendments to them filed with the
32 register of deeds pursuant to Article 2E of Chapter 136 of the
33 General Statutes. The assessor must indicate on all tax maps
34 maintained by the county or city that portion of the properties
35 embraced within a transportation corridor and must note any
36 variance granted for the property for such period as the
37 designation remains in effect. The assessor must tax the
38 property within a transportation corridor as required under G.S.
39 105-277.9."
40 Section 6. G.S. 105-322(e) reads as rewritten:
41 "(e) Time of Meeting. -- Each year the board of equalization
42 and review shall hold its first meeting not earlier than the
43 first Monday in April and not later than the first Monday in May.
44 In years in which a county does not conduct a real property

revaluation, the board shall complete its duties on or before the third Monday following its first meeting unless, in its opinion, a longer period of time is necessary or expedient to a proper execution of its responsibilities. ~~In no event shall~~ Except as provided in subdivision (g)(5) of this section, the board may not sit later than July 1 except to hear and determine requests made under the provisions of subdivision (g)(2), below, when such requests are made within the time prescribed by law. In the year in which a county conducts a real property revaluation, the board shall complete its duties on or before December 1, except that it may sit after that date to hear and determine requests made under the provisions of subdivision (g)(2), below, when such requests are made within the time prescribed by law. From the time of its first meeting until its adjournment, the board shall meet at such times as it deems reasonably necessary to perform its statutory duties and to receive requests and hear the appeals of taxpayers under the provisions of subdivision (g)(2), below."

Section 7. G.S. 105-322(g) reads as rewritten:

"(g) Powers and Duties. -- The board of equalization and review has the following powers and duties:

(1) ~~Powers and Duties. -- It shall be the duty of the board of equalization and review to~~ Duty to Review Tax Lists. -- The board shall examine and review the tax lists of the county for the current year to the end that all taxable property shall be listed on the abstracts and tax records of the county and appraised according to the standard required by G.S. 105-283, and the board shall correct the abstracts and tax records to conform to the provisions of this Subchapter. In carrying out its responsibilities under this subdivision (g)(1), the board, on its own motion or on sufficient cause shown by any person, shall:

a. List, appraise, and assess any taxable real or personal property that has been omitted from the tax lists.

b. Correct all errors in the names of persons and in the description of properties subject to taxation.

c. Increase or reduce the appraised value of any property that, in the board's opinion, ~~shall have~~ has been listed and appraised at a figure that is below or above the appraisal required by G.S. 105-283; however, the board shall not

change the appraised value of any real property from that at which it was appraised for the preceding year except in accordance with the terms of G.S. 105-286 and 105-287.

d. Cause to be done whatever else ~~shall be~~ is necessary to make the lists and tax records comply with the provisions of this Subchapter.

e. Embody actions taken under the provisions of subdivisions (g)(1)a through (g)(1)d, above, in appropriate orders and have the orders entered in the minutes of the board.

f. Give written notice to the taxpayer at ~~his~~ the taxpayer's last-known address in the event the ~~board shall,~~ board, by appropriate order, ~~increase~~ increases the appraisal of any property or ~~list~~ lists for taxation any property omitted from the tax lists under the provisions of this subdivision (g)(1).

(2) Duty to Hear Taxpayer Appeals. -- On request, the board of equalization and review shall hear any taxpayer who owns or controls property taxable in the county with respect to the listing or appraisal of ~~his~~ the taxpayer's property or the property of others.

a. A request for a hearing under this subdivision (g)(2) shall be made in writing to or by personal appearance before the board prior to its adjournment. However, if the taxpayer requests review of a decision made by the board under the provisions of subdivision (g)(1), above, notice of which was mailed fewer than 15 days prior to the board's adjournment, the request for a hearing thereon may be made within 15 days after the notice of the board's decision was mailed.

b. Taxpayers may file separate or joint requests for hearings under the provisions of this subdivision (g)(2) at their election.

c. At a hearing under provisions of this subdivision (g)(2), the board, in addition to the powers it may exercise under the provisions of subdivision (g)(3), below, shall hear any evidence offered by the appellant, the assessor, and other county officials that

1 is pertinent to the decision of the appeal.
2 Upon the request of an appellant, the board
3 shall subpoena witnesses or documents if there
4 is a reasonable basis for believing that the
5 witnesses have or the documents contain
6 information pertinent to the decision of the
7 appeal.
8 d. On the basis of its decision after any hearing
9 conducted under this subdivision (g)(2), the
10 board shall adopt and have entered in its
11 minutes an order reducing, increasing, or
12 confirming the appraisal appealed or listing
13 or removing from the tax lists the property
14 whose omission or listing has been appealed.
15 The board shall notify the appellant by mail
16 as to the action taken on ~~his~~ the taxpayer's
17 appeal not later than 30 days after the
18 board's adjournment.
19 (3) Powers in Carrying Out Duties. -- In the
20 performance of its duties under subdivisions (g)(1)
21 and (g)(2), above, the board of equalization and
22 review may exercise the following powers:
23 a. It may appoint committees composed of its own
24 members or other persons to assist it in
25 making investigations necessary to its work.
26 It may also employ expert appraisers in its
27 discretion. The expense of the employment of
28 committees or appraisers shall be borne by the
29 county. The board may, in its discretion,
30 require the taxpayer to reimburse the county
31 for the cost of any appraisal by experts
32 demanded by ~~him~~ the taxpayer if the appraisal
33 does not result in material reduction of the
34 valuation of the property appraised and if the
35 appraisal is not subsequently reduced
36 materially by the board or by the Department
37 of Revenue.
38 b. The board, in its discretion, may examine any
39 witnesses and documents. It may place any
40 witnesses under oath administered by any
41 member of the board. It may subpoena
42 witnesses or documents on its own motion, and
43 it must do so when a request is made under the
44 provisions of subdivision (g)(2)c, above.

1 A subpoena issued by the board shall be
2 signed by the ~~chairman~~ chair of the board,
3 directed to the witness or to the person
4 having custody of the document, and served by
5 an officer authorized to serve subpoenas. Any
6 person who willfully fails to appear or to
7 produce documents in response to a subpoena or
8 to testify when appearing in response to a
9 subpoena shall be guilty of a Class 1
10 misdemeanor.
11 (4) Power to Submit Reports. -- Upon the completion of
12 its other duties, the board may submit to the
13 Department of Revenue a report outlining the
14 quality of the reappraisal, any problems it
15 encountered in the reappraisal process, the number
16 of appeals submitted to the board and to the
17 Property Tax Commission, the success rate of the
18 appeals submitted, and the name of the firm that
19 conducted the reappraisal. A copy of the report
20 should be sent by the board to the firm that
21 conducted the reappraisal.
22 (5) Duty to Change Abstracts and Records After
23 Adjournment. -- Following adjournment upon
24 completion of its duties under subdivisions (g)(1)
25 and (g)(2) of this subsection, the board may
26 continue to meet to carry out the following duties:
27 a. To hear and decide all appeals relating to
28 discovered property under G.S. 105-312(d) and
29 (k).
30 b. To hear and decide all appeals relating to the
31 appraisal, situs, and taxability of classified
32 motor vehicles under G.S. 105-330.2(b).
33 c. To hear and decide all appeals relating to
34 audits conducted under G.S. 105-296(j) and
35 relating to audits conducted under G.S. 105-
36 296(j) and (l) of property classified at
37 present-use value and property exempted or
38 excluded from taxation."
39 Section 8. G.S. 105-330.4(b) reads as rewritten:
40 " (b) Subject to the provisions of G.S. 105-395.1, interest on
41 unpaid taxes on classified motor vehicles listed pursuant to G.S.
42 105-330.3(a)(1) accrues at the rate of ~~three-fourths of one~~
43 ~~percent (3/4%) per month beginning~~ two percent (2%) for the
44 first month following the date the taxes were due and three-

1 fourths percent (3/4%) for each month thereafter until the taxes
2 are paid, unless the tax notice required by G.S. 105-330.5 is
3 prepared after the date the taxes are due. In that circumstance,
4 the interest accrues beginning the second month following the
5 date of the notice until the taxes are paid. Subject to the
6 provisions of G.S. 105-395.1, interest on delinquent taxes on
7 classified motor vehicles listed pursuant to G.S. 105-330.3(a)(2)
8 accrues as provided in G.S. 105-360(a) and discounts shall be
9 allowed as provided in G.S. 105-360(c)."
10 Section 9. G.S. 105-375(i) reads as rewritten:
11 "(i) Issuance of Execution. -- At any time after ~~six~~ three
12 months and before two years from the indexing of the judgment as
13 provided in subsection (b), above, execution shall be issued at
14 the request of the tax collector in the same manner as executions
15 are issued upon other judgments of the superior court, and the
16 real property shall be sold by the sheriff in the same manner as
17 other real property is sold under execution with the following
18 exceptions:
19 (1) No debtor's exemption shall be allowed.
20 (2) In lieu of personal service of notice on the owner
21 of the property, registered or certified mail
22 notice shall be mailed to the listing owner ~~(and to~~
23 ~~the current owner if notice was required to be~~
24 ~~mailed to him pursuant to subsection (c), above)~~
25 at ~~this [his]~~ the listing owner's last known
26 address at least 30 days prior to the day fixed for
27 the sale. The notice must also be mailed to the
28 current owner by registered or certified mail if
29 notice was required to be mailed to the current
30 owner pursuant to subsection (c) of this section.
31 (3) The sheriff shall add to the amount of the judgment
32 as costs of the sale any postage expenses incurred
33 by the tax collector and the sheriff in foreclosing
34 under this section.
35 (4) In any advertisement or posted notice of sale under
36 execution, the sheriff may (and at the request of
37 the governing body shall) combine the
38 advertisements or notices for properties to be sold
39 under executions against the properties of
40 different taxpayers in favor of the same taxing
41 unit or group of units; however, the property
42 included in each judgment shall be separately
43 described and the name of the listing taxpayer
44 specified in connection with each.

1 The purchaser at the execution sale shall acquire title to the
2 property in fee simple free and clear of all claims, rights,
3 interests, and liens except the liens of other taxes or special
4 assessments not paid from the purchase price and not included in
5 the judgment."
6 Section 10. G.S. 131-21 reads as rewritten:
7 "**§ 131A-21. Tax exemption.**
8 The exercise of the powers granted by this Chapter will be in
9 all respects for the benefit of the people of the State and will
10 promote their health and welfare. If bonds or notes are issued
11 by the Commission to provide or improve a health care facility,
12 then until the bonds or notes are retired, the facility for which
13 bonds or notes are issued is exempt from property taxes to the
14 extent provided in this section. If refunding bonds or notes are
15 issued to refund bonds or notes issued to provide or improve a
16 health care facility, the facility will continue to be exempt
17 from property taxes as provided in this section until such time
18 as the refunding bonds or notes are retired, provided that the
19 final maturity of the refunding bonds or notes does not extend
20 beyond the final maturity of the original bonds or notes.
21 Property may be exempt from property taxes as provided in this
22 section if a timely application for the exemption is filed with
23 the assessor of the county in which the property is located as
24 required under G.S. 105-282.1. The property tax exemption under
25 this section shall not exceed the lesser of the original
26 principal amount of the bonds or notes or the assessed value for
27 ad valorem tax purposes of the facility. If bonds or notes are
28 issued to finance more than one health care facility, only that
29 portion of the principal amount of the bonds or notes used to
30 provide or improve the particular facility, including any
31 allocable reserves and financing costs, may be considered for the
32 purpose of determining the amount of the exemption allowable
33 under this section. The exemption authorized by this section
34 shall begin with the first full tax year of the taxpayer
35 following the issuance of the bonds and notes. This section does
36 not affect a health care facility's eligibility for a property
37 tax exemption under Subchapter II of Chapter 105 of the General
38 Statutes.
39 Any bonds or notes issued by the Commission under the
40 provisions of this Chapter shall at all times be free from
41 taxation by the State or any local unit or political subdivision
42 or other instrumentality of the State, excepting inheritance,
43 estate, or gift taxes, income taxes on the gain from the transfer

1 of the bonds and notes, and franchise taxes. The interest on the
2 bonds and notes is not subject to taxation as income."
3 Section 11. Section 2 of this act becomes effective for
4 taxes imposed for taxable years beginning on or after July 1,
5 2002. Section 9 of this act becomes effective July 1, 2001, and
6 applies to an in rem foreclosure proceeding begun on or after
7 that date. Section 8 of this act becomes effective for taxes
8 imposed for taxable years beginning on or after July 1, 2001.
9 The remainder of this act is effective when it becomes law.

BILL ANALYSIS

LEGISLATIVE PROPOSAL 3:
Property Tax Amendments

Committee:	Revenue Laws	**Introduced by:**	
Date:	January 16, 2001	**Summary by:**	Cindy Avrette
Version:	01-RBXZ-302		Committee Counsel

***SUMMARY:** Legislative Proposal 3 makes several changes to the property tax laws recommended by the Department of Revenue, the Institute of Government, and the North Carolina Association of Assessing Officers. Except as otherwise noted in the summary, the changes become effective when they become law.*

- ***It clarifies the application process for property tax exemptions and exclusions.***
- ***It gives the assessor the authority to remove a property's preferential tax classification if the taxpayer does not provide the assessor with the information requested to verify the property's qualifications for the preferential tax classification.***
- ***It gives all boards of equalization and review the authority to meet after it adjournment date to hear use value, exempt property, discoveries, and motor vehicle valuation cases.***
- ***It clarifies the changes allowed in a non-reappraisal year.***
- ***It shortens the waiting period for en rem foreclosures.***
- ***It conforms the interest rate on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes.***

Section 1 clarifies when an application for a property tax exemption or exclusion must be made. As a general rule, property tax exemptions and exclusions, and preferential property tax rates and values, must be applied for annually. However, some exemptions and exclusions may apply automatically, while others need to be applied for only once. The Department of Revenue, Property Tax Division, undertook a thorough examination of the exemptions and exclusions and their application process. This section represents its suggestion of the appropriate application time period for all of the property tax exemptions and exclusions. In most instances, the time period remains the same. However, in a few instances, annual application classifications are moved to a single application requirement: severable development rights; real and personal property belonging to the NC Low-Level Radioactive Waste Management Authority or to the NC Hazardous Waste management Commission; objects of art held by the NC Art Society; property of private water companies; and Brownfields property. In four instances, the application period is changed so that the preferential classification attaches automatically without the property owner needing to apply at all: poultry, livestock, and feed used in the production of poultry and livestock; vehicles subject to the gross receipts tax on short-term rentals; buildings equipped with a solar energy heating or cooling system; real property that lies within a transportation corridor.

Effective for taxes imposed for taxable years beginning on or after July 1, 2002, Section 2 provides additional reasons the assessor may increase or decrease a property's value during a non-revaluation year:

- A change in value resulting from a physical change to the land or to the improvements on the land, such as an addition to a structure.
- A change in value resulting from a change in the legally permitted use of the property, such as a zoning change.

Sections 3 and 4 provides that property may lose its preferential tax status if the owner of the property does not make information necessary to determine the property's preferential treatment available to the tax assessor when asked to do so. Under current law, the assessor must annually review 1/8 of the properties exempt or excluded from taxation to verify that they continue to qualify for their exemption or exclusion. Likewise, the assessor must annually review 1/8 of the properties classified for present-use value to verify that they qualify for the preferential tax value. The law requires the owner to provide the information requested by the assessor to determine the property's qualifications for the exemption or exclusion. However, the current law does not provide a consequence if the owner fails to give the requested information to the assessor. These sections seek to give the assessor a means to obtain the information that is needed to verify the property's preferential tax classification when the owner is not willing to cooperate.

Section 5 requires the assessor to annually review the transportation corridor official maps and amendments to them. These properties are currently taxed at 20% of the general tax rate.

Sections 6 and 7 provides that the Board of Equalization and Review may meet after its adjournment date to hear appeals relating to motor vehicle property taxes, discoveries, and property reviewed annually to determine its continued qualification for exemption or exclusion. Currently, Cabarrus, Lincoln, and Stokes Counties have this local authority.

Section 8 conforms the interest rate due on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes: 2% for the first month following the date the taxes were due and ¾% for each month thereafter. Under current law, the amount of interest due on unpaid motor vehicle taxes is ¾% per month. This amount is not enough to encourage people to pay their tax in a timely manner. This change in the law becomes effective for taxes imposed for taxable years beginning on or after July 2, 2001.

Section 9 shortens the waiting period in en rem foreclosures from six month to three months. Current law allows a property tax judgment to be executed at any time after six months and before two years from the indexing of the judgment. This change would allow the judgment to be acted upon within three months of the date the judgment is indexed. This change becomes effective July 1, 2001, and applies to en rem foreclosure proceedings begun on or after that date.

Lastly, Section 10 clarifies that the tax exemption created in Chapter 131A must be applied for in a timely manner on an annual basis.

Fiscal Analysis Memorandum

DATE: **January 4, 2001**

TO: Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Legislative Proposal 3
Property Tax Amendments - 01-RBXZ-302

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund			No General Fund Impact		
Local Governments			(See Assumptions and Methodology)		

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, Local Governments.

EFFECTIVE DATE: Section 6 of this act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2002. Section 7 becomes effective July 1, 2001 and applies to an in rem foreclosure proceeding begun on or after tat date. Section 10 becomes effective for taxes imposed for taxable years beginning on or after July 1, 2001. The remainder becomes effective when it becomes law.

BILL SUMMARY: This bill makes several technical changes to the state's property tax laws. The Department of Revenue, the Institute of Government, and the North Carolina Association of Assessing Officers suggested these changes.

Section 1: Under current law applications for exemption or exclusion from property taxes can be required annually, on a one time only basis, or not at all. The bill clarifies that, in general, property owners must file for a property tax exemption or exclusion annually (during the listing period). It also shifts the following groups of property from a one-time application requirement to a category that does not require any application.

- Poultry, livestock, and feed for poultry and livestock,
- Vehicles subject to the gross receipts tax on short-term rentals,
- Buildings with solar energy systems, and

- Real property in a transportation corridor.

The bill shifts the following groups of property from an annual application to a one-time application requirement.

- Property owned by a non-profit community group listed in 105-275(20).
- Severable development rights.
- Real and personal property belonging to the NC Low-Level Radioactive Waste Management Authority or the NC Hazardous Waste Management Commission.
- Objects of art held by the NC Art Society.
- Property of private water companies.
- Brownfields property.

Section 2: Authorizes assessors to change a property valuation in a non-revaluation year if there has been a physical change to the land or an improvement, such the addition of a structure, or a change in the legally permitted use of the property.

Sections 3: Authorizes county assessors to remove the preferential tax status afforded properties under the Machinery Act if the property owner does not provide the information necessary to determine if the parcel qualifies once the information is requested.

Section 4: Provide that property may lose its use value classification and associated preferential tax treatment if the owner does not provide the assessor with the information needed to determine eligibility within 30 days of the request.

Section 5: Directs assessors to review transportation corridor maps annually.

Sections 6 and 7: Authorize local Equalization and Review boards to meet after their official adjournment to hear appeals of motor vehicle property taxes, discoveries, and property reviewed annually to determine its continued qualification for exemption or exclusion

Section 8: Conforms the interest rate on unpaid motor vehicle taxes to the interest rate on other unpaid property taxes (2% for the first month and ¾% each month thereafter).

Section 9: Shortens the waiting period in en rem foreclosures from six months to three months.

Section 10: Clarifies that health care facilities exempt under G.S. 131A must apply annually, and in a timely manner, for their exemption.

ASSUMPTIONS AND METHODOLOGY:

Section 1: Allowing assessors to remove preferential tax treatment if appropriate information is not provided is the only portion of the Part I that may have a fiscal impact. If assessors remove the tax status, and that taxpayer never provides the information local governments could see a net revenue gain. However, both the NC Association of Assessing Officers and the Department of Revenue believe this is unlikely. They suggest the legislation will only give local governments a tool to prod taxpayers to act. As such, no noticeable revenue increase is expected. Because the

balance of Part I only addresses the timing of application and not the qualifications for property to be exempt or excluded no fiscal impact is expected.

Section 2: Since this provision changes the conditions for a value change it will have some fiscal impact on local governments. The impact could be positive or negative depending on the changes made to the property and its use. Fiscal Research does not have sufficient data to make an estimate at this time. The Department of Revenue, however, believes the overall impact on revenues will be minimal.

Sections 3 and 4: If assessors remove the use value status, and that taxpayer never provides the information, local governments could see a small net revenue gain. However, because the primary effect of this portion of the bill will be to prod taxpayers to act, no noticeable revenue increase is expected.

Section 5: No impact.

Sections 6 and 7: No impact.

Section 8: Since this section increases the interest rate on delinquent motor vehicles taxes local governments will see a small revenue gain. However, the counties hope that increasing the rate will cause taxpayers to make their payments sooner, thus reducing any potential net increase. Fiscal Research is unable to make an estimate at this time due to limited data, but expects the increase to be very small statewide.

Section 9: Because the bill only shifts the timeline and not the substance of en rem foreclosures no fiscal impact is expected.

Section 10: No impact.

LEGISLATIVE PROPOSAL #4

WETLANDS REIMBURSE/LOCAL TAX BASE

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 4:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO REQUIRE STATE AND LOCAL GOVERNMENT AGENCIES THAT ACQUIRE LAND FOR WETLANDS MITIGATION TO REIMBURSE THE COUNTY IN WHICH THE LAND IS LOCATED FOR ITS LOST TAXES DUE TO THE ACQUISITION

SHORT TITLE: Wetlands Reimburse/Local Tax Base.

BRIEF OVERVIEW: This proposal requires a unit of local government that purchases or condemns land for the purpose of wetlands mitigation to pay to the county where the land is located a sum equal to the estimated amount of ad valorem taxes that would have accrued to the county for the next 10 years had the land not been acquired. This requirement does not apply to a condemnation or acquisition of land by a city if the land is within the corporate limits of that city or within the county where the city is located. The proposal also requires a State agency that purchases land for wetlands mitigation to pay the lost taxes to the county where the land is located. This requirement does not apply when a State agency purchases land for wetlands mitigation and this land is located in the same county as the wetlands permitted to be lost. In other circumstances a State agency is not required to reimburse the county for the amount of the lost taxes if the governing body of the county agrees in writing to waive the payment. The proposal applies only to land acquired in Tier one and Tier two counties.

FISCAL IMPACT: The proposal does not impact the State General Fund. It may cost the Highway Fund $437,500 over the next 5 years and it may cost the Wetlands Mitigation Fund $36,006 over the next 5 years.

EFFECTIVE DATE: The proposal is effective when it becomes law and applies to transfers made on or after that date.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

01-LA-002
THIS IS A DRAFT (12-12-00)

Short Title: Wetlands Reimburse/Local Tax Base. (Public)

Sponsors:

Referred to: Environment and Natural Resources.

1 A BILL TO BE ENTITLED
2 AN ACT TO REQUIRE STATE AND LOCAL GOVERNMENT AGENCIES THAT
3 ACQUIRE LAND FOR WETLANDS MITIGATION TO REIMBURSE THE COUNTY IN
4 WHICH THE LAND IS LOCATED FOR ITS LOST TAXES DUE TO THE
5 ACQUISITION.
6 The General Assembly of North Carolina enacts:
7 Section 1. Article 2 of Chapter 153A of the General
8 Statutes is amended by adding a new section to read:
9 "§ 153A-15.1. Agreement to make payment in lieu of future ad
10 valorem taxes required before wetlands acquisition by a unit of
11 local government.
12 (a) Condemnation. -- Notwithstanding the provisions of G.S.
13 153A-15, Chapter 40A of the General Statutes, or any other
14 general law or local act conferring the power of eminent domain,
15 before a final judgment may be entered or a final condemnation
16 resolution adopted in an action of condemnation initiated by a
17 unit of local government whose property is exempt from tax under
18 Section 2(3) of Article V of the North Carolina Constitution,
19 whereby the condemnor seeks to acquire land for the purpose of
20 wetlands mitigation, the condemnor shall agree in writing to pay
21 to the county where the land is located a sum equal to the
22 estimated amount of ad valorem taxes that would have accrued to
23 the county for the next 10 years had the land not been acquired
24 by the condemnor.

1 (b) Purchase. -- Notwithstanding the provisions of G.S. 130A-
2 55, 153A-15, 153A-158, 160A-240.1, or any other general law or
3 local act conferring the power to acquire real property, before
4 any unit of local government whose property is exempt from tax
5 under Section 2(3) of Article V of the North Carolina
6 Constitution purchases any land for the purpose of wetlands
7 mitigation, the unit shall agree in writing to pay to the county
8 where the land is located a sum equal to the estimated amount of
9 ad valorem taxes that would have accrued to the county for the
10 next 10 years had the land not been acquired by the acquiring
11 unit.
12 (c) Definition. -- For purposes of this section, the "estimated
13 amount of ad valorem taxes that would have accrued for the next
14 10 years" means the total assessed value of the acquired land
15 excluded from the county's tax base multiplied by the tax rate
16 set by the board of commissioners in its most recent budget
17 ordinance adopted under Chapter 159 of the General Statutes, and
18 then multiplied by 10.
19 (d) Exception. -- This section does not apply to any
20 condemnation or acquisition of land by a city if the land to be
21 condemned or acquired is within the corporate limits of that city
22 or within the county where the city is located.
23 (e) Application. -- This section applies only to land acquired
24 in counties designated as an enterprise tier one area or
25 enterprise tier two area under G.S. 105-129.3."
26 Section 2. G.S. 143-214.11 is amended by adding a new
27 subsection to read:
28 "(g) Payment for Taxes. -- A State agency acquiring land to
29 restore, enhance, preserve, or create wetlands must also pay a
30 sum in lieu of ad valorem taxes lost by the county in accordance
31 with G.S. 146-22.3."
32 Section 3. G.S. 143-214.12(a) reads as rewritten:
33 "(a) Wetlands Restoration Fund. -- The Wetlands Restoration
34 Fund is established as a nonreverting fund within the Department.
35 The Fund shall be treated as a special trust fund and shall be
36 credited with interest by the State Treasurer pursuant to G.S.
37 147-69.2 and G.S. 147-69.3. The Wetlands Restoration Fund shall
38 provide a repository for monetary contributions and donations or
39 dedications of interests in real property to promote projects for
40 the restoration, enhancement, preservation, or creation of
41 wetlands and riparian areas and for payments made in lieu of
42 compensatory mitigation as described in subsection (b) of this
43 section. No funds shall be expended from this Fund for any
44 purpose other than those directly contributing to the

1 acquisition, perpetual maintenance, enhancement, restoration, or
2 creation of wetlands and riparian areas in accordance with the
3 basinwide plan as described in G.S. 143-214.10. The cost of
4 acquisition includes a payment in lieu of ad valorem taxes
5 required under G.S. 146-22.3 when the Department is the State
6 agency making the acquisition."
7 Section 4. Article 6 of Chapter 146 of the General
8 Statutes is amended by adding a new section to read:
9 "**§ 146-22.3. Acquisition of land to be used to restore, enhance,**
10 **preserve, or create wetlands.**
11 (a) Payment. -- A State agency that acquires land by purchase
12 for the purpose of restoring, enhancing, preserving, or creating
13 wetlands as required by a permit or an authorization issued by
14 the United States Army Corps of Engineers under 33 U.S.C. § 1344
15 must pay to the county in which the land is located, as
16 reimbursement, a sum equal to the estimated amount of ad valorem
17 taxes that would have accrued to the county for the next 10 years
18 had the land not been acquired by the State agency.
19 (b) Exception. -- This section does not apply when the land
20 purchased by the State agency and the wetlands permitted to be
21 lost are located in the same county. In other circumstances, the
22 governing body of the county and the State agency may enter into
23 a written agreement to waive payment.
24 (c) Amount. -- The estimated amount of ad valorem taxes that
25 would have accrued for the next 10 years is the total assessed
26 value of the acquired land excluded from the county's tax base
27 multiplied by the tax rate set by the board of commissioners in
28 its most recent budget ordinance adopted under Chapter 159 of the
29 General Statutes, and then multiplied by 10.
30 (d) Application. -- This section applies only to land acquired
31 in counties designated as an enterprise tier one area or
32 enterprise tier two area under G.S. 105-129.3."
33 Section 5. Article 6 of Chapter 146 of the General
34 Statutes is amended by adding a new section to read:
35 "**§ 146-22.4. Acquisition of wetlands from private mitigation**
36 **banking companies.**
37 (a) Payment for Taxes. -- A State agency that acquires
38 wetlands from a private mitigation banking company, must pay a
39 sum in lieu of ad valorem taxes to the county where the wetlands
40 are located. The sum is equal to the estimated amount of ad
41 valorem taxes that would have accrued for the next 10 years as
42 computed in G.S. 146-22.3(c).
43 (b) Requirement for Acquisition. -- A State agency may require,
44 as a condition of accepting a donation of wetlands by a private

1 mitigation banking company, that the company make adequate
2 provisions for the long term maintenance and management of the
3 wetlands. These provisions may include reimbursement to the
4 agency for payment of a sum in lieu of ad valorem taxes.
5 (c) Application. -- This section applies only to land acquired
6 in counties designated as an enterprise tier one area or
7 enterprise tier two area under G.S. 105-129.3"
8 Section 6. This act is effective when it becomes law,
9 and applies to transfers made on or after that date.

BILL ANALYSIS

LEGISLATIVE PROPOSAL 4
Wetlands Reimburse/Local Tax Base

Committee: Revenue Laws
Date: December 12, 2000
Version: 01-LA-002

Introduced by:
Summary by: Martha K. Walston
Staff Attorney

SUMMARY: *Legislative Proposal 4 requires a unit of local government that purchases or condemns land for the purpose of wetlands mitigation to pay to the county where the land is located a sum equal to the estimated amount of ad valorem taxes that would have accrued to the county for the next 10 years had the land not been acquired. This requirement does not apply to a condemnation or acquisition of land by a city if the land is within the corporate limits of that city or within the county where the city is located. The draft also requires a State agency that purchases land for wetlands mitigation to pay the lost taxes to the county where the land is located. This requirement does not apply when a State agency purchases land for wetlands mitigation and this land is located in the same county as the wetlands permitted to be lost. In other circumstances a State agency is not required to reimburse the county for the amount of the lost taxes if the governing body of the county agrees in writing to waive the payment. The draft bill is similar to House Bill 1232 introduced by Representative Tucker during the 1999 Session. Senate Bill 1085 was a companion bill introduced by Senator Albertson. Neither bill passed out of committee. The draft bill applies only to land acquired in Tier one and Tier two counties.*

CURRENT LAW: The Wetlands Restoration Program and Fund was established by the General Assembly in 1996 for two purposes: restoring wetlands lost or impaired through human activities and assisting those who must meet wetlands mitigation requirements imposed by the U.S. Army Corps of Engineers as a condition of obtaining Section 404 permits for wetlands alteration. (Section 404 of the U.S. Clean Water Act, which controls the placement of dredged or fill materials in the waters of the U.S. and adjoining wetlands, is the nearest thing to a national wetlands law. Under some circumstances wetlands may be disturbed if other wetlands are protected in mitigation). Wetlands include pocosins, freshwater marshes, swamp forests, and bottomland hardwood forests. In the past two decades, wetlands have been altered because of development and agricultural and timber operations. The current law encourages the streamlining of wetlands permitting and provides for state oversight of private wetlands mitigation banking (a business which trades in properties that may be eligible as mitigations lands).

DENR is responsible for administering the wetlands restoration program. Specifically, DENR is directed to develop basinwide plans covering all 17 major river basins for wetlands and riparian area restoration, to establish a standardized schedule of per-acre payments in lieu of compensatory mitigation, to coordinate compensatory mitigation required by the Corps, and to enter a memorandum of agreement with the Corps to ensure that the Corps is satisfied with the

state's implementation of the restoration program. The Corps' mitigation requirements may be satisfied either by donation of property or by monetary contributions that meet the DENR payments schedule.

When wetlands are acquired by a State agency or local government for wetlands mitigation, this land is removed from the tax base of the county where the land is located. This land becomes exempt because the State and local governments are exempt from property taxes. This situation has adversely impacted counties where a major component of their tax base is land.

G.S. 153A-15 authorizes 83 counties to require the consent and approval of the county board of commissioners where the land is located when a unit of local government in another county seeks to condemn or acquire this land. This requirement does not apply if a city condemns or acquires property within the corporate limits of that city. However, the counties have no such authority when property is acquired by a State agency

BILL ANALYSIS: **Section 1** of the bill requires a unit of local government, that has acquired land by condemnation or purchase for the purpose of wetlands mitigation, to pay the county where the land is located a sum equal to the estimated amount of ad valorem taxes that would have accrued to the county for the next 10 years had the land not been acquired by the local government. This requirement does not apply to the condemnation or purchase of land by a city if the land is located in the corporate limits of the city or within the county where the city is located.

The bill defines the "estimated amount of ad valorem taxes that would have accrued for the next 10 years" to mean the total assessed value of the acquired land excluded from the county's tax base multiplied by the tax rate set by the board of commissioners in its most recent budget ordinance adopted under Chapter 159 of the General Statutes, and then multiplied by 10.

Section 2 requires a State agency that is acquiring land for wetlands mitigation to pay to the county where the land is located a sum in lieu of ad valorem taxes lost by the county. This sum is calculated by using the formula for "estimated amount of ad valorem taxes that would have accrued for the next 10 years".

Section 3 amends the statute setting out the Wetlands Restoration Fund to allow DENR to use money in the Fund to pay the amount of lost ad valorem taxes when DENR is the State agency purchasing the property in a county for wetlands mitigation.

Section 4 adds a new section to Article 6 of Chapter 146 of the General Statutes to require a State agency that purchases land for wetlands mitigation pursuant to a permit or authorization issued by the US Army Corps of Engineers to pay the county an amount equal to the "estimated amount of ad valorem taxes that would have accrued to the county for the next 10 years". The payment is not required by a State agency when the land purchased by the State agency and the wetlands permitted to be lost are located in the same county. In other circumstances the governing board of the county and the State agency may agree in writing to waive payment.

Section 5 adds a new section to Article 6 of Chapter 146 that requires a State agency that acquires wetlands from a private mitigation banking company, to pay a sum in lieu of ad

valorem taxes to the county where the wetlands are located. As a condition of accepting wetlands from the company, the State agency may require the company to provide for the maintenance and management of the wetlands. This requirement may include reimbursement to the State agency for payment of the sum in lieu of ad valorem taxes. Private mitigation banking companies often donate wetlands to State agencies when the credits for the wetlands have been sold and the banking companies no longer want to maintain the property.

Section 6 makes the act effective when it becomes law and applicable to transfers made on or after that date.

The bill applies only to land acquired in counties designated as an enterprise tier one area or enterprise tier two area.

Fiscal Analysis Memorandum

DATE: **December 18, 2000**

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Legislative Proposal 4: Wetland Reimbursement/Local Tax Base

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
Local Government	**(See Assumptions and Methodology)**				
EXPENDITURES					
General Fund	**(See Assumptions and Methodology)**				
Highway Trust Fund/ Available Federal Highway Funds	**$437,500 over the five year period***				
Wetlands Mitigation Fund	**$36,006***	**$36,006***	**$36,006***	**$36,006***	**$36,006***

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Transportation, Highway Trust Fund, Wetlands Mitigation Program in the Department of Environment and Natural Resources, other state agencies, local governments.

EFFECTIVE DATE: When it becomes law and applies to transfers made on or after that date.

BILL SUMMARY: Under current federal environmental regulations, when wetlands are lost or impaired other land in the same river basin (or sub river basin) must be permanently set aside to "make up" for the lost wetlands. This practice is referred to as compensatory wetland mitigation. The state is also subject to these federal permitting requirements. As such, they often purchase land for wetland mitigation. In addition, the NC Wetlands Restoration Program and Fund (DENR) is instructed by statute to purchase land to restore wetlands lost or impaired through human activities and assist others who are required to meet wetland restoration targets. When the state or another government purchases land, the land is removed from the county's property tax base and is exempt from taxes. The bill requires state and local governments that purchase or condemn land for wetland mitigation make a lump sum payment equal to ten (10) years of property taxes when the property transfers to the government and is removed from the property tax base. Payment is not required when the mitigation land is acquired in the same county as the original impact. The county can also agree to waive the payment requirement. The bill authorizes use of Wetlands Restoration Program

funds for DENR wetland mitigation. The bill also requires that state agencies make the ten year payment when they acquire wetlands from a private mitigation bank, and can make provision of these funds a part of the property acquisition agreement. None of the payment requirements apply in enterprise tier 3, 4, or 5 areas.

ASSUMPTIONS AND METHODOLOGY:
This bill is not expected to impact cost estimates associated with construction projects for community colleges, state universities, or prisons, based on current construction plans. Fiscal Research believes the primary state impact will be in the areas of highway construction (DOT) and the DENR wetlands mitigation program. As a result, no direct general fund impact is expected.

The North Carolina Department of Transportation projects that this bill carries a potential cost to their department of $437,500 over the next five years. This estimate assumes that DOT purchases 5,000 acres for wetlands mitigation with a total value of $6.25 million ($1,250 per acre). Applying the average tax rate for tier 1 and tier 2 counties of $0.70, and multiplying that amount by 10 (the bill requires a lump sum payment equal to 10 years of taxes) results in the $437,500 estimate.

Officials with the North Carolina Wetland Restoration Program estimate the cost to their program will be $36,006 annually. This estimate assumes that 85 acres are purchased annually at an average cost of $6,000 acre. Applying a $0.706/100 property tax rate and multiplying that by ten years creates the lump sum payment of $36,006 annually. (85 acres x $6,000 per acre x $0.706/100 tax rate x 10 = $36,006). While this is shown as an annual cost to the fund, staff plan to adjust the fee they charge for mitigation to cover the additional expense.

All loses to the NCDOT and the Wetlands program are revenue gains for local governments. As a result, local governments will see a gain of $617,530 ($437,500 + ($36,006 x 5 years)) over five years. However, some of that gain may be offset by local government payment into the Wetland Restoration program to cover their mitigation needs.

The final potential cost of the bill relates to private mitigation banks. The bill forces state agencies to make a lump sum payment to counties when the agency acquires land from a private mitigation bank. However, because the agency can recoup the cost from the mitigation bank when the property is transfer, no agency impact is expected.

All estimates consider only acquisitions in tier 1 and tier 2 counties.

* Both the NCDOT and the Wetlands Restoration Fund indicate these are maximum estimates given environmental regulations at this time. They are maximum estimates because they assume none of the mitigation property purchases will be in the same county as the impact. They also assume that no county will waive payment, and that agencies follow their current construction plans. Future changes in environmental regulations could have a significant impact on the numbers.

LEGISLATIVE PROPOSAL #5

EXTEND TAX DEADLINE

LEGISLATIVE PROPOSAL 5:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO WAIVE THE PENALTIES FOR FAILURE TO MEET CERTAIN TAX-RELATED DEADLINES BECAUSE OF A PRESIDENTIALLY DECLARED DISASTER.

SHORT TITLE: Extend Tax Deadline.

BRIEF OVERVIEW: This proposal waives the penalties for failure to obtain a license, failure to file a return, and failure to pay taxes when due, if these activities should be performed during the period of time federal tax-related deadlines have been extended by the Secretary of the Treasury in an area of the State because of a Presidentially declared disaster.

FISCAL IMPACT: Insignificant.

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

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S or H D

2001-LA-001
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Extend Tax Deadline. (Public)

Sponsors: .

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO WAIVE THE PENALTIES FOR FAILURE TO MEET CERTAIN TAX-
3 RELATED DEADLINES BECAUSE OF A PRESIDENTIALLY DECLARED
4 DISASTER.
5 The General Assembly of North Carolina enacts:
6 Section 1. G.S. 105-237(a) reads as rewritten:
7 "(a) Waiver. -- The Secretary may, upon making a record of the
8 reasons therefor, reduce or waive any penalties provided for in
9 this Subchapter. <u>The penalties in G.S 105-236(2), (3), and (4)</u>
10 <u>do not apply to returns, reports, and payments due during the</u>
11 <u>period in which the time for filing a federal return or report or</u>
12 <u>for paying a federal tax is extended under section 7508A of the</u>
13 <u>Code because of a Presidentially declared disaster. For the</u>
14 <u>purpose of this section, "Presidentially declared disaster" has</u>
15 <u>the same meaning as in section 1003(h)(3) of the Code.</u>"
16 Section 2. This act is effective when it becomes law.

LEGISLATIVE PROPOSAL 5: Extend Tax Deadline

BILL ANALYSIS

Committee: Revenue Laws
Date: October 16, 2000
Version: 2001-LA-001

Introduced by:
Summary by: Martha K. Walston
Committee Counsel

SUMMARY: This draft waives the penalties for failure to obtain a license, failure to file a return, and failure to pay taxes when due, if these activities should be performed during the period of time federal tax-related deadlines have been extended by the Secretary of the Treasury in an area of the State because of a Presidentially declared disaster.

CURRENT LAW:

State Law: G.S. 105-263 gives the Secretary of Revenue the authority to extend the time to file a report or return with the Secretary. An extension of time for filing a franchise tax return, income tax return, or gift tax return DOES NOT extend the time for paying the tax due or the time when a penalty attaches for failure to pay the tax. An extension of time for any other return or report DOES extend the time for paying the tax due and the time when a penalty attaches for failure to pay the tax. When an extension of time for filing a report or return extends the time for paying the tax expected to be due, interest accrues on the tax due from the original due date of the report or return to the date the tax is paid.

Federal Law:
Section 7508A AUTHORITY TO POSTPONE CERTAIN TAX-RELATED DEADLINES BY REASON OF PRESIDENTIALLY DECLARED DISASTER.
This section authorizes the Secretary of the Treasury or his delegate to prescribe regulations to postpone certain deadlines for up to 90 days for a taxpayer affected by a Presidentially declared disaster area. A "Presidentially declared disaster area" means any disaster which, with respect to the area in which the property is located, resulted in a subsequent determination by the President that the area warrants assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act. The deadlines that may be postponed are the same deadlines that may be postponed by reason of service in a combat zone. They include the deadlines for:

1. the filing of any return of income, estate, or gift tax (except for employment or withholding taxes),
2. the payment of any income, estate, or gift tax (except employment or withholding taxes),
3. the filing of a Tax Court petition for redetermination of a deficiency or review of a Tax Court decision,
4. the allowance of a credit or refund,
5. the filing of a claim for credit or refund,
6. the bringing of any suit on the claim for credit or refund,
7. the assessment of any tax,
8. the giving or making of any notice or demand for payment of any tax or with respect to any liability to the IRS in respect of any tax,
9. the collection by levy or otherwise of any tax liability,
10. the bringing of a suit by the U.S. with respect to any tax liability, and
11. any other act required or permitted under the related regulations.

The postponement under this section does not apply to the determination of interest on any overpayment or underpayment. However, section 6404(h) of the Code requires the IRS to abate the assessment of interest penalties in Presidentially declared disaster areas if the time for filing an income tax return and paying income tax is extended.

BACKGROUND*:

Hurricane Fran (September 1996)
State Extension of Time: Taxpayers with tax returns and payments due from September 5 through September 16, 1996 were granted extensions to September 30 to file returns and make payments without penalty. Interest continued to accrue on unpaid tax. Forced collection activities were suspended until October 15. Forced collection activities include such activities as the issuance of garnishments, tax warrants, and certificates of tax liabilities.
Federal Extension of Time: Taxpayers with estimated tax payments or corporate, partnership, or fiduciary returns due on September 15 were granted extensions until September 30. The IRS could not extend the deadline for employment or exise tax deposits but promised to abate any penalties on late payments that were due from September 4 through 15 if paid by September 30. Enforcement activities were suspended until October 15.

Hurricane Floyd (September 1999)
State Extension of Time: The Department of Revenue waived late filing and late payment penalties for taxpayers who had taxes due on or after September 15, but were unable to file returns or pay taxes because of the storm. Penalties were automatically waived through December 15. After December 15, penalty waivers were determined on an individual case basis. Interest continued to accrue on unpaid tax. Forced collection activities were suspended until December 15. The suspension was continued in individual cases depending on the taxpayer's circumstances.
Federal Extension of Time: The IRS originally announced that taxpayers with estimated tax payments or corporate, partnership, or fiduciary returns due on September 15 were granted extensions until September 30. The IRS could not extend the deadline for employment or excise tax deposits but promised to abate any penalties on late payments that were due from September 14 through 22, if paid by October 8. Enforcement activities were suspended until October 15. The IRS subsequently provided additional relief by abating interest for income taxes and by extending tax returns and payments until October 15 for most taxpayers. Also taxpayers in severely affected states, such as North Carolina, were granted extensions until January 31, 2000. Enforcement activities in the severely affected areas were also suspended until January 31, 2000.
* Background infomation provided by the NC Department of Revenue.

BILL ANALYSIS: After Hurricanes Fran and Floyd, the Department of Revenue issued press releases granting the extension of time for tax-related deadlines. The extension of time allowed after Fran was in conformity with the extension granted by the IRS. However the extension of time allowed after Floyd was not as long as the extension allowed by the IRS. After Floyd the State granted an extension of time to December 15, while the IRS extended the time for tax returns and payments and for enforcement activities to January 31. This discrepancy resulted in some North Carolina taxpayers filing their State returns and making payments on the January 31 IRS extension date. These taxpayers were therefore

subject to additional interest and penalties. However, these penalties were waived if the taxpayer notified the Department of Revenue.

This proposal would waive any penalties due for failure to obtain a business license, failure to file a return, and failure to pay taxes if the license, return, or taxes are due during the time federal tax-related deadlines are extended because of a Presidentially declared disaster. The taxpayers residing in the affected area or having a business located in the affected area would still be liable for interest which accrues from the original due date until the date the tax is paid.

This proposal codifies the Department of Revenue's current published penalty policy. Under this policy, the occurrence of a disaster is an automatic reason to waive penalties.

LEGISLATIVE PROPOSAL #6

Support Revenue Audit Report Legislation

LEGISLATIVE PROPOSAL 6
Support Revenue Audit Report

BILL ANALYSIS

Committee: Revenue Laws
Date: January 16, 2001
Version:

Introduced by:
Summary by: Martha H. Harris
Staff Attorney

The State Auditor's Office presented to the Revenue Laws Study Committee a summary of its performance audit of the Department of Revenue. The audit's major conclusions were that the Department of Revenue is operating effectively given its current level of staffing and technology and that the benefits from technology are a 4.8% per year increase in tax revenues, or $726 million per year. The performance audit made recommendations in three major areas: (1) that the State can generate additional revenues through collection and technology changes, including millions of dollars from five specific proposals; (2) that the Department of Revenue can use technology to improve services to citizens; and (3) that the Department of Revenue needs additional staff and continued technology funding to perform its duties more effectively.

The Revenue Laws Study Committee concluded that the performance audit report and the additional funding it recommends for the Department of Revenue is focused on collecting taxes from taxpayers who have filed their returns but not paid their taxes and taxpayers who have not filed their returns. The Committee also found that the recommendations were for funding for technology to enable the Department of Revenue to give better service to tax payers and also to provide better information of the legislature. The Committee determined that auditing taxpayers is not the main purpose for the additional funding recommended for the Department of Revenue, but to actually raise revenues without auditing more taxpayers. For these reasons, the Revenue Laws Study Committee adopted Legislative Proposal 6, Supporting Legislation Implementing

the Recommendations made by the Office of the State Auditor in its Report on the Performance Audit of the Department of Revenue. The Committee did not adopt a specific bill, but decided to support legislation that is being developed jointly by the Office of the State Auditor and the Department of Revenue as part of the work of the North Carolina Tax Policy Study Commission.

LEGISLATIVE PROPOSAL #7

MODIFY PARTNERSHIP TAX CREDIT

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 7:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO MODIFY THE PASS-THROUGH DISTRIBUTION OF PARTNERSHIP INCOME TAX CREDITS.

SHORT TITLE: Modify Partnership Tax Credit.

BRIEF OVERVIEW: Corrects a provision in the statute regarding allocation of partnership tax credits to apply specific dollar amount limitations to the total credit allocated by the partnership, effective in 2002.

FISCAL IMPACT: Insignificant.

EFFECTIVE DATE: The proposal is effective for taxable years beginning on or after January 1, 2002.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

2001-LYX-005(1.1)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Modify Partnership Tax Credit. (Public)

Sponsors: Revenue Laws Study Committee.

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO MODIFY THE PASS-THROUGH DISTRIBUTION OF PARTNERSHIP
3 INCOME TAX CREDITS.
4 The General Assembly of North Carolina enacts:
5 Section 1. G.S. 105-269.15(a) reads as rewritten:
6 "(a) Pass-Through of Credit. -- A partnership may pass through
7 to each of its partners the partner's distributive share of an
8 income tax credit for which the partnership qualifies. Except as
9 otherwise provided in this Chapter, all limitations on an income
10 tax credit apply to the partnership, except the ~~following:~~
11 ~~(1)~~ ~~The~~ limitation that the credit may not exceed the
12 amount of ~~income~~ tax ~~imposed on the taxpayer.~~
13 ~~(2)~~ ~~A cap on the otherwise allowable amount of the~~
14 ~~credit, expressed as a specific maximum dollar~~
15 ~~amount~~ or a specific percentage of tax imposed <u>on</u>
16 <u>the taxpayer</u> for the taxable year."
17 Section 2. This act is effective for taxable years
18 beginning on or after January 1, 2002.

LEGISLATIVE PROPOSAL 7
Modify Partnership Tax Credit

BILL ANALYSIS

Committee: Revenue Laws Study Comm.
Date: September 21, 2000
Version: 2001-LYX-005

Sponsor:
Analysis by: Y. Canaan Huie
Staff Attorney

SUMMARY: ***Corrects a provision in the statute regarding allocation of partnership tax credits to apply specific dollar amount limitations to the total credit allocated by the partnership, effective in 2002.***

Generally, partnerships are treated under North Carolina law as under federal law. Both North Carolina and federal law recognize that a partnership is a separate entity. When the partnership is entitled to a tax credit, that credit is allocated to the partners who then receive the benefit of the credit. This is done because the partnership itself is not a taxable entity. Under current North Carolina law, a partnership may pass though to each of its partners the partner's share of any tax credit for which the partnership is eligible. The partnership is subject to all limitations on income tax credits except for the following[1]:

- The limitation that the credit may not exceed the amount of the income tax imposed on the taxpayer.
- A cap on the otherwise allowable amount of the credit, expressed as a specific maximum dollar amount or a specific percentage of the tax imposed on the taxpayer.

Federal law does not recognize the exemption from a specific dollar amount limitation. Additionally, North Carolina law does not recognize such an exemption for S corporations[2]. Thus, this provision of North Carolina law regarding taxation of partnerships is inconsistent with both federal law regarding taxation of partnerships and with North Carolina law regarding taxation of S corporations.

Additionally, this special provision gives a tax advantage to partnerships over corporations or individuals in certain circumstances. The following example illustrates this point. Consider a business entity that purchases and places into service in North Carolina, in a nonresidential setting, renewable energy property that costs $2 million. Under G.S.105-129.16A, the taxpayer is allowed a credit of 35% of the cost of the property. There is ceiling of $250,000 per installation. If the taxpayer is an individual or a corporation, the amount of the credit is $250,000[3]. If the taxpayer is a partnership, the actual amount of the credit is larger because the specific dollar amount limitation does not apply. The ceiling applies separately to each partner. If there are two equal partners, each partner would be eligible for a $250,000 credit for a total credit of

[1] All limitations on the tax credit apply to each partner individually.
[2] An S corporation is a business entity that is similar in most respects to a partnership for tax purposes.
[3] 35% of $2 million is $700,000. This amount is greater than the ceiling so the credit is limited to $250,000

$500,000[4]. If there are three or more equal partners, the total value of the credit would be $700,000[5].

This bill removes the partnership's exemption from the specific dollar amount limitation. This makes North Carolina law consistent with federal law on this point as well as consistent with North Carolina law regarding S corporations. Additionally, the change would affect relatively few tax credits. The following tax credits have specific dollar amount limitations that would apply to partnerships if this bill becomes law:

- Worker training (G. S. 105-129.11)
- Investing in central administrative office property (G. S. 105-129.12)
- Investing in business property (G. S. 105-129.16)
- Investing in renewable energy property (G. S. 105-129.16A)
- Real property donations (G. S. 105-151.12)
- Conservation tillage equipment (G. S. 105-151.13)
- Construction of a poultry composting facility (G.S. 105-151.25)

Limited liability corporations are treated like partnerships under North Carolina law for income tax purposes. Thus, this change would also apply to limited liability corporations.

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[4] 35% of $2 million is $700,000. Each partner may claim his or her share of the credit up to $250,000. This yields a total credit of $500,000.
[5] 35% of $2 million is $700,000. In the case of three equal partners, each may claim his or her full share of the credit $233,333. This yields a total credit of $700,000.

FISCAL ANALYSIS MEMORANDUM

DATE: December 29, 2000

TO: Revenue Laws Study Committee

FROM: Dave Crotts
Fiscal Research Division

RE: Legislative Proposal 7
Modify Partnership Tax Credit

FISCAL IMPACT

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

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					

PRINCIPAL DEPARTMENTS AFFECTED: The tax credits are administered by the Department of Revenue. The enactment of the proposal will not affect the Department's budget requirements.

EFFECTIVE DATE: Tax years beginning on or after January 1, 2002.

PROPOSAL SUMMARY: Generally, partnerships are treated for State tax purposes in the same fashion as under Federal law. In the case of tax credits, this means that when the partnership is eligible for a tax credit, the credit is allocated to the partners.

Under North Carolina law, certain credits are limited to a specific dollar amount. However, there is an exemption from the cap for partnerships. Thus, the statutory limit applies to each of the partners. This application is inconsistent with Federal rules on partnerships and the State treatment of S corporations, neither of which have such an exemption. The practical effect of the State exemption is to substantially expand the total amount of credit taken.

The proposal eliminates the inconsistency by removing the partnership exemption from the specific dollar amount limitation. Thus, the dollar cap would apply to the partnership instead of individual partners.

ASSUMPTIONS AND METHODOLOGY: There is no available data at this time to assist in the determination of the General Fund revenue gain that would result from the enactment of the proposal. For most tax credits affected, the Department of Revenue does not have available timely tax return data. The most likely credit to be affected is the credit for conservation land donations Though the Department of Environment and Natural Resources has a wealth of data on the usage of the credit since its inception in 1983, the credit limits were increased substantially on January 1, 1999.

To the extent that large donations are made by partnerships with large numbers of partners, the revenue gain from the proposal could be significant. However, the enactment of the proposal would likely limit these types of donations in the future.

LEGISLATIVE PROPOSAL #8

MAKE FRANCHISE TAX MORE EQUITABLE

LEGISLATIVE PROPOSAL 8:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO EQUALIZE THE FRANCHISE TAX TREATMENT OF ENTITIES ORGANIZED AS CORPORATIONS AND ENTITIES TAXED AS CORPORATIONS UNDER FEDERAL LAW AND TO CLARIFY THE FRANCHISE TAX LIABILITY OF CORPORATIONS THAT OWN ENTITIES THAT ARE DISREGARDED FOR TAX PURPOSES.

SHORT TITLE: Make Franchise Tax More Equitable.

BRIEF OVERVIEW: This proposal clarifies that the franchise tax does not apply to limited liability companies that are treated as partnerships for income tax purposes. It applies the corporate franchise tax to business entities that are treated as corporations for federal tax purposes. And it clarifies the franchise tax liability of a corporation that is the sole owner of an entity disregarded for federal income tax purposes.

FISCAL IMPACT: The proposal will produce a General Fund revenue gain from single member LLCs that are not currently subject to the franchise tax. Unfortunately, neither the Department of Revenue nor the Department of Secretary of State can provide information on LLC's needed to estimate the increased tax liability.

EFFECTIVE DATE: The provision imposing the franchise tax on business entities that are treated as corporations for income tax purposes becomes effective for taxable years beginning on or after January 1, 2002. 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 2001

S/H D

2001-LYXZ-010A(1.1)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Make Franchise Tax More Equitable. (Public)

Sponsors: Revenue Laws Study Committee.

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO EQUALIZE THE FRANCHISE TAX TREATMENT OF ENTITIES
3 ORGANIZED AS CORPORATIONS AND ENTITIES TAXED AS CORPORATIONS
4 UNDER FEDERAL LAW AND TO CLARIFY THE FRANCHISE TAX LIABILITY OF
5 CORPORATIONS THAT OWN ENTITIES THAT ARE DISREGARDED FOR TAX
6 PURPOSES.
7 The General Assembly of North Carolina enacts:
8 Section 1. G.S. 105-114(b)(2) reads as rewritten:
9 "(b) Definitions. -- The following definitions apply in this
10 Article:
11 . . .
12
13 (2) Corporation. -- A domestic corporation, a foreign
14 corporation, an electric membership corporation
15 organized under Chapter 117 of the General Statutes
16 or doing business in this State, ~~or an association~~
17 ~~that is organized for pecuniary gain, has capital~~
18 ~~stock represented by shares, whether with or~~
19 ~~without par value, and has privileges not possessed~~
20 ~~by individuals or partnerships. The term includes~~
21 an entity that is treated as a corporation for
22 federal income tax purposes, or a mutual or capital
23 stock savings and loan association or building and
24 loan association chartered under the laws of any

1 state or of the United States. The term does not
2 include a limited liability ~~company.~~ company that
3 is treated as a partnership for income tax
4 purposes."
5 Section 2. G.S. 105-122(b) reads as rewritten:
6 "(b) Every such corporation taxed under this section shall
7 determine the total amount of its issued and outstanding capital
8 stock, surplus and undivided profits; no reservation or
9 allocation from surplus or undivided profits shall be allowed
10 other than for definite and accrued legal liabilities, except as
11 herein provided; taxes accrued, dividends declared and reserves
12 for depreciation of tangible assets as permitted for income tax
13 purposes shall be treated as deductible liabilities. There shall
14 also be treated as a deductible liability reserves for the entire
15 cost of any air-cleaning device or sewage or waste treatment
16 plant, including waste lagoons, and pollution abatement equipment
17 purchased or constructed and installed which reduces the amount
18 of air or water pollution resulting from the emission of air
19 contaminants or the discharge of sewage and industrial wastes or
20 other polluting materials or substances into the outdoor
21 atmosphere or streams, lakes, or rivers, upon condition that the
22 corporation claiming such deductible liability shall furnish to
23 the Secretary a certificate from the Department of Environment
24 and Natural Resources or from a local air pollution control
25 program for air-cleaning devices located in an area where the
26 Environmental Management Commission has certified a local air
27 pollution control program pursuant to G.S. 143-215.112 certifying
28 that the Environmental Management Commission or local air
29 pollution control program has found as a fact that the air-
30 cleaning device, waste treatment plant or pollution abatement
31 equipment purchased or constructed and installed as above
32 described has actually been constructed and installed and that
33 such plant or equipment complies with the requirements of the
34 Environmental Management Commission or local air pollution
35 control program with respect to such devices, plants or
36 equipment, that such device, plant or equipment is being
37 effectively operated in accordance with the terms and conditions
38 set forth in the permit, certificate of approval, or other
39 document of approval issued by the Environmental Management
40 Commission or local air pollution control program and that the
41 primary purpose thereof is to reduce air or water pollution
42 resulting from the emission of air contaminants or the discharge
43 of sewage and waste and not merely incidental to other purposes
44 and functions. The cost of purchasing and installing equipment or

1 constructing facilities for the purpose of recycling or resource
2 recovering of or from solid waste or for the purpose of reducing
3 the volume of hazardous waste generated shall be treated as
4 deductible for the purposes of this section upon condition that
5 the corporation claiming such deductible liability shall furnish
6 to the Secretary a certificate from the Department of Environment
7 and Natural Resources certifying that the Department of
8 Environment and Natural Resources has found as a fact that the
9 equipment or facility has actually been purchased, installed or
10 constructed, that it is in conformance with all rules and
11 regulations of the Department of Environment and Natural
12 Resources, and the recycling or resource recovering is the
13 primary purpose of the facility or equipment. The cost of
14 constructing facilities of any private or public utility built
15 for the purpose of providing sewer service to residential and
16 outlying areas shall be treated as deductible for the purposes of
17 this section; the deductible liability allowed by this section
18 shall apply only with respect to such pollution abatement plants
19 or equipment constructed or installed on or after January 1,
20 1955. Treasury stock shall not be considered in computing the
21 capital stock, surplus and undivided profits as the basis for
22 franchise tax, but shall be excluded proportionately from said
23 capital stock, surplus and undivided profits as the case may be
24 upon the basis and to the extent of the cost thereof. In the case
25 of an international banking facility, the capital base shall be
26 reduced by the excess of the amount as of the end of the taxable
27 year of all assets of an international banking facility which are
28 employed outside the United States over liabilities of the
29 international banking facility owed to foreign persons. For
30 purposes of such reduction, foreign persons shall have the same
31 meaning as defined in G.S. 105-130.5(b)(13)d.
32 Every corporation doing business in this State which is a
33 parent, subsidiary, or affiliate of another corporation shall add
34 to its capital stock, surplus and undivided profits all
35 indebtedness owed to a parent, subsidiary or affiliated
36 corporation as a part of its capital used in its business and as
37 a part of the base for franchise tax under this section. The term
38 "indebtedness" as used in this paragraph includes all loans,
39 credits, goods, supplies, or other capital of whatsoever nature
40 furnished by a parent, subsidiary, or affiliated corporation,
41 other than indebtedness endorsed, guaranteed, or otherwise
42 supported by one of these corporations. The terms "parent,"
43 "subsidiary," and "affiliate" as used in this paragraph shall
44 have the meaning specified in G.S. 105-130.6. If any part of the

1 capital of the creditor corporation is capital borrowed from a
2 source other than a parent, subsidiary or affiliate, the debtor
3 corporation, which is required under this paragraph to include in
4 its tax base the amount of debt by reason of being a parent,
5 subsidiary, or affiliate of the said creditor corporation, may
6 deduct from the debt thus included a proportionate part
7 determined on the basis of the ratio of such borrowed capital as
8 above specified of the creditor corporation to the total assets
9 of the said creditor corporation. Further, in case the creditor
10 corporation as above specified is also taxable under the
11 provisions of this section, such creditor corporation shall be
12 allowed to deduct from the total of its capital, surplus and
13 undivided profits the amount of any debt owed to it by a parent,
14 subsidiary or affiliated corporation to the extent that such debt
15 has been included in the tax base of said parent, subsidiary or
16 affiliated debtor corporation reporting for taxation under the
17 provisions of this section.
18 If a corporation is the sole shareholder or sole member of an
19 entity that is disregarded for federal income tax purposes, the
20 corporation and the disregarded entity are considered the same
21 corporation under this Article. In this circumstance, any
22 income, assets, liabilities, and equity of the disregarded entity
23 are attributed to that corporation and must be included in the
24 corporation's computation of tax under this Article."
25 Section 3. Section 1 of this act is effective for
26 taxable years beginning on ar after January 1, 2002. The
27 remainder of this act is effective when it becomes law.

LEGISLATIVE PROPOSAL 8
Make Franchise Tax More Equitable

BILL ANALYSIS

Committee: Revenue Laws Study Comm.
Date: November 13, 2000
Version: 2001-LYXZ-010A

Sponsor:
Analysis by: Y. Canaan Huie
Staff Attorney

SUMMARY: ***Clarifies that the franchise tax does not apply to limited liability companies that are treated as partnerships for income tax purposes. Applies the corporate franchise tax to business entities that are treated as corporations for federal tax purposes. Clarifies the franchise tax liability of a corporation that is the sole owner of an entity disregarded for federal income tax purposes***

For federal income tax purposes, certain entities, such as an LLC[1], can be treated as a corporation, a partnership, or a disregarded entity. The "check the box" regulations at 26 C.F.R. 301-7701 determine how an LLC is treated. If a business entity has two or more owners it is classified as either a corporation or a partnership. If a business entity has only one owner, it is either classified as a corporation or is disregarded as an entity separate from its owner. Certain business entities are always classified as corporations[2]. Other business entities may elect their classifications.

Under current North Carolina law, no LLC is subject to the franchise tax. In 1997, the North Carolina law regarding LLCs was changed to allow for a single-member LLC. This change had the unintended consequence of opening a loophole in North Carolina tax law. Under current law, a corporation subject to North Carolina franchise tax may set up an LLC. Then the corporation can transfer assets to the LLC in a tax-free transfer. The assets then held by the LLC would not be subject to the franchise tax. Thus, the corporation could avoid a significant portion of its franchise tax liability by transferring assets into a wholly owned LLC subsidiary without affecting its income tax liability.

This bill would close this loophole and make the following changes:

- This bill would impose the franchise tax on business entities that are treated as corporations for income tax purposes. This would subject any limited liability company that is treated as a corporation for income tax purposes to the franchise tax.
- This bill clarifies that the franchise tax is not imposed on an LLC that is treated as a partnership for income tax purposes.

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[1] A limited liability company (LLC) is a business entity that is essentially a hybrid of a partnership and a corporation. Like a corporation, an LLC limits the liability of its owners. Like a partnership, an LLC is usually not subject to entity-level taxation.
[2] Among others, these entities include State-chartered business entities that conduct banking activities and insurance companies.

- Under this bill, a corporation that is the sole shareholder or sole member of a disregarded entity would be required to include the income, assets, liabilities, and equity of the disregarded entity in the corporation's computation of franchise tax.

FISCAL ANALYSIS MEMORANDUM

DATE: January 17, 2001

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal 8
Make Franchise Tax More Equitable

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES	see ASSUMPTIONS AND METHODOLOGY				
EXPENDITURES					
POSITIONS:					

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

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2001.

BILL SUMMARY: The bill clarifies that the franchise tax is not imposed on a Limited Liability Company (LLC) that is treated as a partnership for income tax purposes. However, LLC's that are treated as corporations are subject to the franchise tax. The bill requires a corporation that is the sole shareholder or sole member of a disregarded entity to include the income, assets, liabilities, and equity of the disregarded entity in the corporation's computation of franchise tax. A disregarded entity is a business entity that is treated separate from its owner for tax purposes.

ASSUMPTIONS AND METHODOLOGY:
This legislation should produce a General Fund revenue gain from single member Limited Liability Companies (LLC's) that are not currently subject to the franchise tax. Unfortunately,

neither the Department of Revenue nor the Department of Secretary of State can provide information on LLC's needed to estimate the increased tax liability.

The Corporations Division of the Department of Secretary of State is responsible for registering the approximately 40,000 LLC's in North Carolina. LLC's file their articles of incorporation with the Corporations Division and pay a $125 filing fee. The initial LLC information requested by the Secretary of State is limited to 1) class of stock, 2) number of shares of stock authorized, 3) street address and county of registered office and name of registered agent, and 4) name and address of company incorporators. The Secretary of State does not request the tax status of the LLC nor does it require the LLC to list whether it is single member or a multiple member entity. Annual reports are required of LLC's, but the state does not require the LLC to list the following financial information needed to calculate the franchise tax: 1) capital stock, surplus and undivided profits apportioned to NC, 2) appraised value of real estate and tangible personal property, and 3) net book value of real and tangible personal property.

Of those LLC's that reported their business activity in North Carolina, the top five occupations were:

1. Real estate = 48%
2. Finance and insurance = 11%
3. Construction = 8%
4. Retail trade = 6%
5. Professional, Scientific and Technical Services = 5%

Facing a similar lack of data on LLC's, the Tennessee legislature passed Public Chapter No. 421 in 1997 to require LLC's to provide information to the Department of Revenue that could be used to evaluate the impact of LLC's on the state's revenue system. The Tennessee Department of Revenue surveyed approximately 16,000 LLC's in 1998. A total of 11,140 surveys were returned for a response rate of 69.6%. The key survey results are as follows:

- 83.8% of the LLC's do business in the state
- On federal tax filings, 81.1% identified themselves as partnerships, 7.2% corporations, 3.2% proprietorships, and 8.4% other
- Most LLC's are small operations with 60.8% claiming no employees and 21.2% claiming 1 to 4 employees.
- 45.1% of LLC's had net receipts of less than $5,000
- 26.5% of LLC's were involved in real estate – the most identified business activity

If it is assumed that North Carolina LLC's are similar to Tennessee, then 81.1% of the 40,000 Tarheel LLC's are partnerships and are not subject to the franchise tax. The remaining 18.9% of the LLC's (7,560) will be subject to the franchise tax. The Tax Research Division of the Department of Revenue is currently sampling LLC returns to estimate the impact of this proposed bill. Unfortunately, the Department's estimate is not yet available.

LEGISLATIVE PROPOSAL #9

EQUALIZE SALES TAX ON SOFTWARE

LEGISLATIVE PROPOSAL 9:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO TREAT SALES OF COMPUTER SOFTWARE EQUALLY FOR SALES AND USE TAX PURPOSES REGARDLESS OF THE METHOD OF DELIVERY.

SHORT TITLE: Equalize Sales Tax on Software.

BRIEF OVERVIEW: This proposal modifies the sales and use tax on software to include software that is delivered electronically.

FISCAL IMPACT: This proposal is expected to generate approximately $1,000,000 in fiscal year 2001-02 for the State General Fund. It is expected to generate approximately $800,000 in fiscal year 2002-03. The estimate falls to $100,000 after fiscal year 2002-03 because the use tax line item will no longer appear on the individual income tax return for tax years beginning on or after January 1, 2003.

EFFECTIVE DATE: The proposal becomes effective July 1, 2001, and applies to sales made on or after that date.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H **D**

2001-LYXZ-013B(1.1)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Equalize Sales Tax on Software. (Public)

Sponsors: Revenue Laws Study Committee.

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO TREAT SALES OF COMPUTER SOFTWARE EQUALLY FOR SALES AND
3 USE TAX PURPOSES REGARDLESS OF THE METHOD OF DELIVERY.
4 The General Assembly of North Carolina enacts:
5 Section 1. G.S. 105-164.3(20) reads as rewritten:
6 "(20) Tangible personal property. -- Personal property
7 that may be seen, weighed, measured, felt, or
8 touched or is in any other manner perceptible to
9 the senses. The term does not include stocks,
10 bonds, notes, insurance, or other obligations or
11 securities, nor does it include water delivered by
12 or through main lines or pipes either for
13 commercial or domestic use or consumption. The
14 term includes computer software whether delivered
15 electronically or on a storage medium, such as a
16 cd rom, a disk, or a tape."
17 Section 2. This act becomes effective July 1, 2001, and
18 applies to sales made on or after that date.

BILL ANALYSIS

LEGISLATIVE PROPOSAL 9: Equalize Sales Tax on Software

Committee: Revenue Laws
Date: January 23, 2001
Version: 2001-LYXZ-013B

Sponsor:
Analysis by: Y. Canaan Huie
Staff Attorney

SUMMARY: ***Modifies the sales and use tax on software to include software that is delivered electronically.***

ANALYSIS: North Carolina currently applies the sales and use to sales of computer software that are delivered on a storage medium such as a cd-rom, disk, or tape.[1] Such software is specifically included in the definition of tangible personal property. By implication, this definition excludes from taxation computer software that is delivered by electronic means. An example of computer software that is delivered by electronic means is a program that is downloaded over the Internet. Thus, under current law, sales of most computer software are either taxable or tax-exempt based on the method of delivery.

> **Example:** Under current North Carolina law, if a consumer purchases Intuit's TurboTax in a brick-and-mortar store, the sales and use tax applies. However, if the consumer purchases the same computer software and downloads it from the Internet, the sales and use tax does not apply. In this case, the tax status of the purchase is determined solely by the method of delivery.

This bill changes the definition of tangible personal property. This bill expands the definition of tangible personal property to include computer software that is delivered electronically.

[1] Custom computer software is exempted from the sales and use tax pursuant to G.S. 105-164.13. "Custom computer software" is software that is written in accordance with the specifications of a specific customer.

FISCAL ANALYSIS MEMORANDUM

DATE: January 3, 2001

TO: Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Legislative Proposal 9
Equalize Sales Tax on Software

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund	**$1,000,000**	**$800,000**		**less than $100,000 annually**	

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

EFFECTIVE DATE: July 1, 2001.

BILL SUMMARY: Under current law software is considered tangible personal property. As a result, the North Carolina sales and use tax is currently applied to the sale of computer software delivered on a storage medium such as a disk, tape, or CD-ROM. The bill clarifies that tangible personal property includes computer software whether delivered on a storage medium or electronically (via the internet). By including electronic transfers in the definition the bill effectively clarifies that the sales and use tax applies to computer software delivered electronically.

ASSUMPTIONS AND METHODOLOGY:

The International Data Corporation estimated that in 1997 approximately $200 million was spent nationwide on electronically downloaded software, or EDS. The Software Information Industry Association (SIIA) believes that number will increase to just under $1billion nationally in 2001. Using the North Carolina's percent of the U.S. population as a proxy for the state's portion of the EDS market suggests that $28.6 million will be spent in North Carolina in 2001 for EDS.

Because the sale will be handled electronically, and will often be supplied by a non-North Carolina vendor, the primary collection avenue is the use tax. The North Carolina Department of Revenue reports that approximately five million dollars in use tax revenue was collected through the use tax line item on the individual income tax form. This represents 4% of the outstanding estimated use tax liability from remote sales. Using the 4% collection rate as a proxy, Fiscal Research estimates that this bill will yield approximately $1 million annually. However, industry analysts believe this market may have peaked as most major software companies are moving towards providing this software on a subscriber or fee for service basis (Building the Net: Trends Report 2000, Trends Shaping the Digital Economy, SIIA). Also, this estimate assumes the Department of Revenue will adjust the table used for estimating use tax liability to include this category of sales.

Most of the revenue gain from the bill will be lost in 2003-04 as the use tax line item will no longer appear on the individual income tax return for tax years beginning on or after January 1, 2003.

This bill is a part of the streamlining process required for North Carolina's participation in the national streamlined sales tax project.

LEGISLATIVE PROPOSAL #10

STREAMLINED SALES & USE TAX AGREEMENT

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 10:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO ENABLE NORTH CAROLINA TO ENTER THE STREAMLINED SALES AND USE TAX AGREEMENT.

SHORT TITLE: Streamlined Sales and Use Tax Agreement.

BRIEF OVERVIEW: This proposal enables North Carolina to enter into the Streamlined Sales and Use Tax Agreement. Part 1 of the proposal adopts the Uniform Sales and Use Tax Administration Act. Under the Act, the Secretary of Revenue would have the authority to enter into the Streamlined Sales and Use Tax Agreement. To enter into the Agreement, the State must adopt certain uniform provisions that are required under the Uniform Sales and Use Tax Administration Act, such as uniform audit procedures, uniform state rates, uniform standards, and uniform definitions. The State adopted uniform audit procedures and standards last session. Part 2 of the proposal would conform the State's current sales and use tax definitions to the uniform definitions required under the Agreement.

FISCAL IMPACT: The fiscal impact of the proposal is undeterminable at this time.

EFFECTIVE DATE: The part of the proposal enacting the Uniform Sales and Use Tax Administration Act becomes effective when it becomes law. The part of the proposal conforming the State's current sales and use tax definitions to the uniform definitions becomes effective January 1, 2002, if the Streamlined Sales and Use Tax Agreement becomes effective before August 1, 2001. If the Act does not become effective before August 1, 2001, then that part of the proposal becomes effective on the first day of the fourth month after the Agreement does become effective.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

01-RBXZ-206
THIS IS A DRAFT 23-JAN-01 12:44:39

Short Title: Streamlined Sales and Use Tax Agreement. (Public)

Sponsors:

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO ENABLE NORTH CAROLINA TO ENTER THE STREAMLINED SALES
3 AND USE TAX AGREEMENT.
4 The General Assembly of North Carolina enacts:
5
6 PART 1. UNIFORM SALES AND USE TAX ADMINISTRATION ACT
7
8 Section 1.1. Article 5 of Chapter 105 of the General
9 Statutes is amended by adding a new Part 7A to be titled "Uniform
10 Sales and Use Tax Administration Act." The following statutes
11 are recodified in the new Part 7A: G.S. 105-164.43A(a) is
12 recodified as G.S. 105-164.42H(a); G.S. 105-164.43A(b) is
13 recodified as G.S. 105-164.42I(a); G.S. 105-164.43B is recodified
14 as G.S. 105-164.42I(b).
15 Section 1.2. G.S. 105-164.43C is repealed.
16 Section 1.3. Part 7A of Article 5 of Chapter 105 of the
17 General Statutes, as created in Section 1 of this act, reads as
18 rewritten:
19 "Part 7A. Uniform Sales and Use Tax Administration Act.
20 "§ 105-164.42A. Short title.
21 This Part is the 'Uniform Sales and Use Tax Administration Act'
22 and may be cited by that name.
23 "§ 105-164.42B. Definitions.
24 The following definitions apply in this Part:

1 (1) Agreement. -- The Streamlined Sales and Use Tax
2 Agreement.
3 (2) Certified automated system. -- Software certified
4 jointly by the states that are signatories to the
5 Agreement to calculate the tax imposed by each
6 jurisdiction on a transaction, determine the amount
7 of tax to remit to the appropriate state, and
8 maintain a record of the transaction.
9 (3) Certified service provider. -- An agent certified
10 jointly by the states that are signatories to the
11 Agreement to perform all of the seller's sales tax
12 functions.
13 (4) Member state. -- A state that has entered into the
14 Agreement.
15 (5) Person. -- Defined in G.S. 105-228.90.
16 (6) Sales tax. -- The tax levied in G.S. 105-164.4.
17 (7) Seller. -- A person making sales, leases, or
18 rentals of personal property or services.
19 (8) State. -- The term 'this State' means the State of
20 North Carolina. Otherwise, the term 'State' means
21 any state of the United States and the District of
22 Columbia.
23 (8) Use tax. -- The tax levied in G.S. 105-164.6.
24 **"§ 105-164.42C. Authority to enter Agreement.**
25 The Secretary is authorized to enter into the Agreement with
26 one or more states to simplify and modernize sales and use tax
27 administration in order to substantially reduce the burden of tax
28 compliance for all sellers and for all types of commerce. The
29 Secretary may act jointly with other member states to establish
30 standards for certification of a certified service provider and a
31 certified automated system and to establish performance standards
32 for multistate sellers.
33 The Secretary is authorized to represent this State before the
34 other member states. The Secretary may take any other actions
35 reasonably required to implement this Part, including the joint
36 procurement with other member states of goods and services in
37 furtherance of the Agreement.
38 **"§ 105-164.42D. Relationship to North Carolina law.**
39 No provision of the Agreement authorized by this Part
40 invalidates or amends any provision of the law of this State.
41 Adoption of the Agreement by this State does not amend or modify
42 any law of this State. Implementation of a condition of the
43 Agreement in this State must be made pursuant to an act of the
44 General Assembly.

1 "§ 105-164.42E. Agreement requirements.
2 The Secretary may not enter into the Agreement unless the
3 Agreement requires each state to abide by the following
4 requirements:
5 (1) Uniform state rate. -- The Agreement must set
6 restrictions to achieve more uniform state rates
7 through the following:
8 a. Limiting the number of state rates.
9 b. Eliminating maximums on the amount of state
10 tax that is due on a transaction.
11 c. Eliminating thresholds on the application of a
12 state tax.
13 (2) Uniform standards. -- The Agreement must establish
14 uniform standards for all of the following:
15 a. The sourcing of transactions to taxing
16 jurisdictions.
17 b. The administration of exempt sales.
18 c. The allowances a seller can take for bad
19 debts.
20 d. Sales and use tax returns and remittances.
21 (3) Uniform definitions. -- The Agreement must require
22 states to develop and adopt uniform definitions of
23 sales and use tax terms. The definitions must
24 enable a state to preserve its ability to make
25 policy choices not inconsistent with the uniform
26 definitions.
27 (4) Central registration. -- The Agreement must provide
28 a central, electronic registration system that
29 allows a seller to register to collect and remit
30 sales and use taxes for all signatory states.
31 (5) No nexus attribution. -- The Agreement must provide
32 that registration with the central registration
33 system and the collection of sales and use taxes
34 taxes in the signatory states will not be used as a
35 factor in determining whether the seller has nexus
36 with a state for any tax.
37 (6) Local sales and use taxes. -- The Agreement must
38 provide for reduction of the burdens of complying
39 with local sales and use taxes through one or more
40 of the following:
41 a. Restricting and eliminating variances between
42 the state and local tax bases.
43 b. Requiring states to administer any sales and
44 use taxes levied by local jurisdictions within

1 the state so that sellers collecting and
2 remitting these taxes will not have to
3 register or file returns with, remit funds to,
4 or be subject to independent audits from local
5 taxing jurisdictions.
6 c. Restricting the frequency of changes in the
7 local sales and use tax rates and setting
8 effective dates for the application of local
9 jurisdictional boundary changes to local sales
10 and use taxes.
11 d. Providing notice of changes in local sales and
12 use tax rates and of changes in the boundaries
13 of local taxing jurisdictions.
14 (7) Monetary allowances. -- The Agreement must outline
15 any monetary allowances that are to be provided by
16 the states to sellers or certified service
17 providers.
18 (8) State compliance. -- The Agreement must require
19 each state to certify compliance with the terms of
20 the Agreement before becoming a member state and to
21 maintain compliance, under the laws of the member
22 state, with all provisions of the Agreement while a
23 member.
24 (9) Consumer privacy. -- The Agreement must require
25 each state to adopt a uniform policy for certified
26 service providers that protects the privacy of
27 consumers and maintains the confidentiality of tax
28 information.
29 **"§ 105-164.42F. Cooperating sovereigns.**
30 The Agreement authorized by this Part is an accord among
31 individual cooperating sovereigns in furtherance of their
32 governmental functions. The Agreement provides a mechanism among
33 the member states to establish and maintain a cooperative,
34 simplified system for the application and administration of sales
35 and use taxes under the laws of each member state.
36 **"§ 105-164.42G. Effect of Agreement.**
37 Entry of this State into the Agreement does not create a cause
38 of action or a defense to an action. No person may challenge any
39 action or inaction by a department, agency, or other
40 instrumentality of this State, or a political subdivision of this
41 State, on the ground that the action or inaction is inconsistent
42 with the Agreement. No law of this State, or its application,
43 may be declared invalid on the ground that the provision or
44 application is inconsistent with the Agreement.

1 "§ 105-164.42H. **Certification of certified automated system and**
2 **effect of certification.**
3 (a) ~~Software.~~ Certification. -- The Secretary may certify a
4 software program as a certified ~~sales tax collection program~~
5 automated system if the Secretary determines that the program
6 correctly determines all of the following and that the software
7 can generate reports and returns required by the Secretary:
8 (1) The applicable combined State and local sales and
9 use tax rate for a sale, based on a ship-to
10 address.
11 (2) Whether or not an item is exempt from tax, based on
12 a uniform product code or another method.
13 (3) Whether or not an exemption certificate offered by
14 a purchaser is a valid certificate, based on the
15 Department's registry of holders of exemption
16 certificates.
17 (4) The amount of tax to be remitted for each taxpayer
18 for a reporting period.
19 (5) Any other issue necessary for the application or
20 calculation of sales and use tax due.
21 (b) Liability. -- A seller may choose to use a certified
22 automated system in performing its sales tax administration
23 functions. A seller that uses a certified automated system is
24 liable for sales and use taxes due on transactions it processes
25 using the certified automated system except for underpayments of
26 tax attributable to errors in the functioning of the system. A
27 person that provides a certified automated system is responsible
28 for the proper functioning of that system and is liable for
29 underpayments of tax attributable to errors in the functioning of
30 the certified automated system.
31 "§ 105-164.42I. **Contract with certified service provider and**
32 **effect of contract.**
33 (a) ~~Tax Collector.~~ Certification. -- The Secretary may certify
34 an entity as a ~~Certified Sales Tax Collector~~ certified service
35 provider if the entity meets all of the following requirements:
36 (1) The entity uses a certified ~~sales tax collection~~
37 ~~program.~~ automated system.
38 (2) The entity has agreed to update its program upon
39 notification by the Secretary.
40 (3) The entity integrates its certified ~~sales tax~~
41 ~~collection program~~ automated system with the system
42 of a ~~retailer~~ seller for whom the entity collects
43 tax so that the tax due on a sale is determined at
44 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~~ sellers 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.

(b) Contract. -- The Secretary may contract with a ~~Certified Sales Tax Collector~~ certified service provider for the collection and remittance of sales and use taxes. A ~~Certified Sales Tax Collector~~ certified service provider must file with the Secretary a bond or an irrevocable letter of credit in the amount set by the Secretary. A bond must be conditioned upon compliance with the contract, be payable to the State, and be in the form required by the Secretary. The amount a ~~Certified Sales Tax Collector~~ certified service provider charges under the contract is a cost of collecting the tax and is payable from the amount collected.

(c) Liability. -- A seller may contract with a certified service provider to collect and remit sales and use taxes payable to the State on sales made by the seller. A certified service provider with whom a seller contracts is the agent of the seller. As the seller's agent, the certified service provider, rather than the seller, is liable for sales and use taxes due this State on all sales transactions the certified service provider processes for the seller unless the seller misrepresents the type of products it sells or commits fraud. A seller that misrepresents the type of products it sells or commits fraud is liable for taxes not collected as a result of the misrepresentation or fraud.

(d) Audit and Review. -- In the absence of misrepresentation or fraud, a seller that contracts with a certified service provider is not subject to audit on the transactions processed by the certified service provider. A seller is subject to audit for transactions not processed by the certified service provider. The State may perform a system check of a seller and review a seller's procedures to determine if the certified service provider's system is functioning properly and the extent to which the seller's transactions are being processed by the certified service provider. A certified service provider is subject to audit.

"§ 105-164.42J. Performance standard for multistate seller.

1 The Secretary may establish a performance standard for a seller
2 that is engaged in business in this State and at least 10 other
3 states and has developed a proprietary system to determine the
4 amount of sales and use taxes due on transactions. A seller that
5 enters into an agreement with the Secretary that establishes a
6 performance standard for that system is liable for the failure of
7 the system to meet the performance standard."
8
9 PART 2. CONFORMING CHANGES
10
11 Section 2.1. The introductory language of G.S. 105-
12 164.3 reads as rewritten:
13 "§ 105-164.3. Definitions.
14 The following definitions apply in this ~~article, except when~~
15 ~~the context clearly indicates a different meaning:~~ Article:"
16 Section 2.2. G.S. 105-164.3, as amended by Section 2.1
17 of this act, is amended by adding the following new subdivisions:
18 "§ 105-164.3. Definitions.
19 The following definitions apply in this Article:
20 ....
21 (2a) Candy. -- A preparation of sugar, honey, or other
22 natural or artificial sweeteners in combination
23 with chocolate, fruits, nuts, or other
24 ingredients or flavorings in the form of bars,
25 drops, or pieces that do not require
26 refrigeration. The term does not include any
27 preparation that contains flour.
28 ....
29 (4a) Delivery charges. -- Charges imposed by the
30 retailer for preparation and delivery of personal
31 property or services to a location designated by
32 the consumer.
33 ....
34 (4b) Dietary supplement. -- A product that is intended
35 to supplement the diet of humans and is required
36 to be labeled as a dietary supplement under
37 federal law, identifiable by the "Supplement
38 Facts" box found on the label.
39 ....
40 (5a) Food. -- Substances that are sold for ingestion
41 or chewing by humans and are consumed for their
42 taste or nutritional value. The substances may
43 be in liquid, concentrated, solid, frozen, dried,
44 or dehydrated form. The term does not include

1 alcoholic beverages, as defined in G.S. 105-
2 113.68, or tobacco products, as defined in G.S.
3 105-113.4.
4 ....
5 (5b) Food sold through a vending machine. -- Food
6 dispensed from a machine or another mechanical
7 devise that accepts payment.
8 ....
9 (12a) Purchase price. -- The term has the same meaning
10 as the term "sales price" when applied to an item
11 subject to use tax.
12 ....
13 (16b) Soft drink. -- A non-alcoholic beverage that
14 contains natural or artificial sweeteners. The
15 term does not include beverages that contain one
16 or more of the following:
17 a. Milk or milk products.
18 b. Soy, rice, or similar milk substitutes.
19 c. More than fifty percent (50%) vegetable or
20 fruit juice."
21 Section 2.3. G.S. 105-164.3(11a) reads as rewritten:
22 "(11a) Prepared ~~food and drink.~~ food. -- ~~Meals, food,~~
23 ~~and beverages to which a retailer has added value~~
24 ~~or whose state the retailer has altered (other~~
25 ~~than solely by cooling) by preparing, combining,~~
26 ~~dividing, heating, or serving, in order to make~~
27 ~~them available for immediate human consumption.~~
28 Food that meets at least one of the following
29 conditions:
30 a. It is sold in a heated state or it is heated
31 by the retailer.
32 b. It consists of two or more foods mixed or
33 combined by the retailer for sale as a single
34 item.
35 c. It is sold with eating utensils provided by
36 the retailer, such as plates, knives, forks,
37 spoons, glasses, cups, napkins, and straws.
38 The term does not include food the retailer
39 sliced, repackaged, or pasteurized but did not
40 otherwise process."
41 Section 2.4. G.S. 105-164.3(13) reads as rewritten:
42 "(13) ~~"Retail" shall mean the sale of any tangible~~
43 ~~personal property in any quantity or quantities~~
44 ~~for any use or purpose on the part of the~~

1 ~~purchaser other than for resale.~~ Retail sale or
2 sale at retail. -- The sale, lease, or rental for
3 any purpose other than for resale, sublease, or
4 subrent."
5 Section 2.5. G.S. 105-164.3(16) reads as rewritten:
6 "(16) ~~Except as provided in paragraph f., "sales price"~~
7 ~~means the total amount for which tangible~~
8 ~~personal property is sold including charges for~~
9 ~~any services that go into the fabrication,~~
10 ~~manufacture or delivery of such tangible personal~~
11 ~~property and that are a part of the sale valued~~
12 ~~in money whether paid in money or otherwise and~~
13 ~~includes any amount for which credit is given to~~
14 ~~the purchaser by the seller without any deduction~~
15 ~~therefrom on account of the cost of the property~~
16 ~~sold, the cost of materials used, labor or~~
17 ~~service costs, interest charged, losses or any~~
18 ~~other expenses whatsoever. Provided, however,~~
19 ~~that where a manufacturer, producer or contractor~~
20 ~~erects, installs or affixes tangible personal~~
21 ~~property upon real property pursuant to a~~
22 ~~construction or performance-type contract with or~~
23 ~~for the benefit of the owner of such real~~
24 ~~property, the sales price shall be the cost of~~
25 ~~such property to the manufacturer, producer or~~
26 ~~contractor performing the contract. Provided,~~
27 ~~further:~~
28 ~~a. The cost for labor or services rendered in~~
29 ~~erecting, installing or applying property sold~~
30 ~~when separately charged shall not be included~~
31 ~~as a part of the "sales price";~~
32 ~~b. Finance charges, service charges or interest~~
33 ~~from credit extended under conditional sales~~
34 ~~contracts or other conditional contracts~~
35 ~~providing for deferred payments of the~~
36 ~~purchase price shall not be considered a part~~
37 ~~of the "sales price" when separately charged;~~
38 ~~c. "Sales price" shall not include the amount of~~
39 ~~any tax imposed by the United States upon or~~
40 ~~with respect to retail sales whether imposed~~
41 ~~upon the retailer or consumer except that any~~
42 ~~manufacturers' or importers' excise tax shall~~
43 ~~be included in the term.~~

~~d. "Sales price" shall not include any amounts charged as deposits on beverage containers which are returnable to vendors for reuse and which amounts are refundable or creditable to vendees, whether or not said deposits are separately charged.~~

~~e. "Sales price" shall not include amounts charged as deposits on aeronautic, automotive, industrial, marine and farm replacement parts which are returnable to vendors for rebuilding or remanufacturing and which amounts are refundable or creditable to vendees, whether or not such deposits are separately charged. This subsection shall not be construed to include tires and batteries.~~

~~f. The sales price of tangible personal property sold through a coin-operated vending machine, other than closed-container soft drinks or tobacco products, is considered to be fifty percent (50%) of the total amount for which the property is sold in the vending machine.~~

Sales price. -- The total amount or consideration for which personal property or services are sold, leased, or rented. The consideration may be in the form of cash, credit, property, or services.

a. The sales price must be valued in money, regardless of whether it is received in money. The term includes all of the following:

1. The retailer's cost of the property sold.
2. The cost of materials used, labor or service costs, interest, losses, all costs of transportation to the retailer, all taxes imposed on the retailer, and any other expense of the retailer.
3. Charges by the retailer for any services necessary to complete the sale.
4. Delivery charges.
5. Installation charges.
6. The value of exempt personal property given to the consumer when

1 taxable and exempt personal property
2 are bundled together and sold by the
3 retailer as a single product or
4 piece of merchandise.
5 b. The term does not include any of the
6 following:
7 1. Discounts, including cash, term, or
8 coupons, that are not reimbursed by
9 a third party, are allowed by the
10 retailer, and are taken by a
11 consumer on a sale.
12 2. Interest, financing, and carrying
13 charges from credit extended on the
14 sale, if the amount is separately
15 stated on the invoice, bill of sale,
16 or a similar document given to the
17 consumer.
18 3. Any taxes imposed directly on the
19 consumer that are separately stated
20 on the invoice, bill of sale, or
21 similar document given to the
22 consumer."
23 Section 2.6. G.S. 105-164.3(16c) is recodified as G.S.
24 105-164.3(16d). G.S. 105-164.3(16b) is recodified as G.S. 105-
25 164.3(16c).
26 Section 2.7. G.S. 105-164.12 is repealed.
27 Section 2.8. G.S. 105-164.13 is amended by adding the
28 following new subdivisions:
29 "(47) An amount charged as a deposit on a beverage
30 container that is returnable to the vendor for
31 reuse when the amount is refundable or creditable
32 to the vendee, whether or not the deposit is
33 separately charged.
34 (48) An amount charged as a deposit on an aeronautic,
35 automotive, industrial, marine, or farm
36 replacement part that is returnable to the vendor
37 for rebuilding or remanufacturing when the amount
38 is refundable or creditable to the vendee,
39 whether or not the deposit is separately charged.
40 This exemption does not include tires or
41 batteries.
42 (49) Installation charges, when the charges are
43 separately stated.

(50) Fifty percent (50%) of the sales price of tangible personal property sold through a coin-operated vending machine, other than closed-container soft drinks and tobacco."

Section 2.9. G.S. 105-164.13B reads as rewritten:

"**§ 105-164.13B. Food exempt from tax.**

~~The~~ Except as provided in this section, the taxes imposed by this Article do not apply to ~~food that is not otherwise exempt pursuant to G.S. 105-164.13 but would be exempt pursuant to G.S. 105-164.13 if it were purchased under the Food Stamp Program, 7 U.S.C. § 51.~~ food. The tax does apply to all of the following:

(1) Candy.

(2) Dietary supplements.

(3) Prepared foods.

(4) Food sold through a vending machine.

(5) Soft drinks."

Section 2.10. Subdivisionon 5(b)(5) of Part IV. of Chapter 903 of the 1983 Session Laws, as amended by Chapter 821 of the 1989 Session Laws, reads as rewritten:

"(b) Definitions. The definitions in G.S. 105-164.3 apply to this Part insofar as they are not inconsistent with the provisions of this Part. In addition, the following definitions apply in this Part.

....

(5) Prepared Food and Beverages. ~~Any food or beverage which a retailer has added value to or has altered its state (other than solely by cooling) by preparing, combining, dividing, heating, or serving, in order to make the food or beverage available for immediate human consumption.~~ The term has the same meaning as the term 'prepared food' in G.S. 105-164.3."

Section 2.11. Subdivision 2(a)(2) of Chapter 413 of the 1993 Session Laws reads as rewritten:

"Sec. 2. Definitions; Sales and Use Tax Statutes. -- (a) The definitions in G.S. 105-164.3 apply to this act to the extent they are not inconsistent with the provisions of this act. In addition, the following definitions apply in this act:

....

(2) Prepared food and beverages. -- ~~Any meals, food, or beverages to which a retailer has added value or has altered its state (other than solely by cooling) by preparing, combining, dividing, heating, or serving, in order to make the food or~~

1 ~~beverage available for immediate human~~
2 ~~consumption.~~ The term has the same meaning as the
3 term 'prepared food' in G.S. 105-164.3."
4 Section 2.12. Section 2 of Chapter 449 of the 1985
5 Session Laws, as amended by Chapter 826 of the 1985 Session Laws
6 and Chapter 177 of the 1991 Session Laws, reads as rewritten:
7 "Sec. 2. Definitions. The definitions in G.S. 105-164.3 apply
8 in this act. In addition, the following definitions apply in
9 this act.
10 (1) Net proceeds. Gross proceeds less the cost to
11 the county of administering and collecting the
12 tax.
13 (2) Prepared food and beverages. ~~Meals, food, and~~
14 ~~beverages which a retailer has added value to or~~
15 ~~whose state has been altered (other than solely~~
16 ~~by cooling) by preparing, combining, dividing,~~
17 ~~heating, or serving, in order to make them~~
18 ~~available for immediate consumption.~~ The term has
19 the same meaning as the term 'prepared food' in
20 G.S. 105-164.3."
21 Section 2.13. Subsection 1(b) of Chapter 449 of the
22 1993 Session Laws reads as rewritten:
23 "(b) Definitions; Sales and Use Tax Statutes. -- The
24 definitions in G.S. 105-164.3 apply to this section to the extent
25 they are not inconsistent with the provisions of this section.
26 In addition, the term "prepared food and beverages" ~~means any~~
27 ~~meals, food, or beverages to which a retailer has added value or~~
28 ~~has altered its state (other than solely by cooling) by~~
29 ~~preparing, combining, dividing, heating, or serving, in order to~~
30 ~~make the food or beverage available for immediate human~~
31 ~~consumption.~~ has the same meaning as the term 'prepared food' in
32 G.S. 105-164.3. The provisions of Article 5 and Article 9 of
33 Chapter 105 of the General Statutes apply to this section to the
34 extent they are not inconsistent with the provisions of this
35 section."
36 Section 2.14. Subdivision (3) of Section 2 of Chapter
37 594 of the 1991 Session Laws reads as rewritten:
38 "Sec. 2. Definitions. The definitions in G.S. 105-
39 164.3 apply to this act to the extent they are not inconsistent
40 with the provisions of this act. The following definitions also
41 apply in this act:
42 ....
43 (3) Prepared food and beverage. ~~Any food or beverage~~
44 ~~to which a retailer has added value or has~~

1 ~~altered its state (other than by cooling alone)~~
2 ~~by preparing, combining, dividing, heating, or~~
3 ~~serving, in order to make the food or beverage~~
4 ~~available for immediate human consumption.~~ The
5 term has the same meaning as the term 'prepared
6 food' in G.S. 105-164.3."
7
8 PART 3. EFFECTIVE DATES
9
10 Section 3.1. Part 1 of this act is effective when it
11 becomes law.
12 Section 3.2. Part 2 of this act becomes effective
13 January 1, 2002, if the Streamlined Sales and Use Tax Agreement
14 becomes effective before August 1, 2001. If the Agreement does
15 not become effective before August 1, 2001, Part 2 becomes
16 effective on the first day of the fourth month after the
17 Agreement does become effective. The Secretary of Revenue must
18 notify the Revisor of Statutes when the Agreement becomes
19 effective.
20 Section 3.3. The remainder of this act is effective
21 when it becomes law.

LEGISLATIVE PROPOSAL 10: Uniform Sales & Use Tax Administration Act

BILL ANALYSIS

Committee:	Revenue Laws	**Introduced by:**	
Date:	January 16, 2001	**Summary by:**	Cindy Avrette
Version:	01-RBXZ-206		Committee Counsel

***SUMMARY:* Legislative Proposal 10 enables North Carolina to enter into the Streamlined Sales and Use Tax Agreement by giving the Secretary of Revenue the authority to enter the Agreement and by making the changes necessary to bring North Carolina's sales and use tax laws into conformity with the model act.**

Background: Last year the Revenue Laws Study Committee recommended, and the General Assembly enacted, legislation to enable North Carolina to participate in the streamlined sales tax collection system pilot project. The project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration. The Streamlined Sales Tax System is focused on improving sales and use tax administration systems for both Main Street and remote sellers for all types of commerce. At least 27 of the 45 states that have a sales and use tax are participating in the project and another 12 states are observing. A "Participating" state is one where the Governor has signed an Executive Order or the legislature has passed legislation authorizing state personnel to participate in the discussions of the project. North Carolina is one of the most active of the participating states involved in the project. "Observer" states represent those states that have expressed an interest in the Project's mission but have not received the executive or legislative authorization to become a Participating state.

The key features of the Streamlined Sales Tax System include:

- Uniform definitions within tax bases. – Legislatures still choose what is taxable and exempt but will use the common definitions.
- Simplified exemption administration for use- and entity-based exemptions. – Sellers are relieved of the "good faith" requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for incorrect exemptions claimed.
- Rate simplification. – States will be responsible for the administration of all state and local taxes and the distribution of the local taxes to the local governments. State and local governments will use common tax bases and accept responsibility for notice of rate and boundary changes. States will be encouraged to simplify their own state and local tax rates.
- Uniform sourcing rules. – The states will have uniform sourcing rules for all property and services.
- Uniform audit procedures. – Sellers who participate in one of the certified Streamlined Sales Tax System technology models will either not be audited or will have a limited scope audit, depending on the technology model used.
- Paying for the system. – To reduce the financial burdens on sellers, states will assume the responsibility for implementing the Streamlined Sales Tax System.

The North Carolina General Assembly made several changes last session in anticipation of this project: simplified exemption administration; uniform audit procedures; certification of software and tax collectors; uniform sourcing rule; limitation of local government rate changes to twice a year; and payment provisions. This proposal builds upon the changes made last session as the model draft legislation continues to develop.

BILL ANALYSIS: Part 1 of Legislative Proposal 10 establishes the Uniform Sales and Use Tax Administration Act. It authorizes the Secretary of Revenue to enter into the Streamlined Sales and Use Tax Agreement. However, the Secretary may not enter into the agreement unless the Agreement requires each state to abide by the following requirements:

- Uniform State Rate.
- Uniform Standards.
- Uniform Definitions.
- Central Registration.
- No Nexus Attribution.
- Local Sales and Use Tax Limitations.
- Monetary Allowances.
- State Compliance Certified.
- Consumer Privacy.

Section 1.1 recodifies many of the provisions the General Assembly enacted last year on this issue into the Uniform Sales and Use Tax Administration Act established in this proposal. Section 1.2 repeals a provision that is incorporated into the Act, which is created under Section 1.3.

Part 2 of Legislative Proposal 10 begins the process of enacting the uniform definitions required to enter into the Streamlined Sales and Use Tax Agreement. The defined terms include: candy, delivery charges, dietary supplements, food and food ingredients, food sold through a vending machine, purchase price, soft drink, prepared food, retail sale, and sales price. Use of the defined terms results in the following changes to the State's sales and use tax laws:

- What food is exempt from sales tax. – The current exemption is based upon what foods may be purchased with food stamps. Use of the uniform definitions bases the exemption upon the defined term "food and food ingredients". Section 2.9 provides that certain food and food ingredients are exempt from tax. The categories of food that would not be exempt from tax under Section 2.9 include: candy, dietary supplements, prepared foods, food sold through vending machines, and soft drinks. The use of the defined term will mean that some food items currently taxed will not be taxed and that others that are now exempt will be taxed. For example, soft drinks purchased in a grocery store are taxable at 2% under the current law because it is considered food for home consumption. Therefore it is exempt from the State sales tax rate of 4%. They would be taxable at 6% under the proposal as drafted because they would no longer be exempt from the State sales tax.

- Delivery charges. – Under the uniform act, all delivery charges would be included in the sales price of an item. Under the current law, delivery charges may or may not be included as part of the sales price, depending upon where the title to the property passes to the purchaser. Under the proposal as drafted, all delivery charges would be included.

- Installation charges. – Under the uniform act, installation charges are included in the sales price. They are not included under current North Carolina law. The proposal includes them in the definition of "sales price" but maintains the current exemption by specifically providing that installation charges are exempt from sales and use tax. (Section 2.8)
- Food purchased from vending machines. – Under the uniform act, food purchased from vending machines is considered food. Under current North Carolina law, food purchased from vending machines is not considered food for home consumption and therefore is taxable. However, through the State's current definition of sales price, North Carolina taxes any tangible item purchased through a vending machine at 50% of its sales price. The proposal provides that food purchased through a vending machine is subject to tax (Section 2.9), however, the current 50% exemption is maintained by specifically listing it as an exemption (Section 2.8).

Legislative Proposal 10 builds upon the work started by this Committee last year. It continues to raise issues that need to be resolved if North Carolina is to enter into the Streamlined Sales Tax Agreement. As the model legislation continues to be developed, the State will need to address other issues raised by it: such as the further development of the uniform sourcing rule.

Part 1 of the act, that enables the Secretary of Revenue to enter into the Agreement, is effective when it becomes law. Part 2 of the act, that begins adopting many of the uniform definitions, would become effective when the Agreement becomes effective, but in no case could it become effective before January 1, 2002. The proponents of the Agreement hope to see the Agreement become effective by August 1, 2001. To become effective, at least five states must enter into the Agreement and adopt the provisions of the model legislation.

FISCAL ANALYSIS MEMORANDUM

DATE: **January 19, 2001**

TO: Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Legislative Proposal 10
Streamline Sales and Use Tax Agreement
01-RBXZ-206

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund	(See Assumptions and Methodology)				
Local Government					

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

EFFECTIVE DATE: Part 1 becomes effective when the bill becomes law. Part 2 becomes effective January 1, 2002 if the Streamlined Sales and Use Tax Agreement comes into effect before August 1, 2001. If the agreement does not become effective before August 1, 2001, Part 2 becomes effective on the first day of the fourth month after the agreement does become effective.

BILL SUMMARY: The bill authorizes the Secretary of Revenue to enter into the national Streamlined Sales and Use Tax Agreement (the Agreement) and sets out a series of definitions and restrictions that must be a part of such an agreement. It also clarifies that no provisions of the Agreement will supplant state law unless that provision is specifically enacted by the General Assembly. Finally, the bill alters and adds definitions of food, food ingredients, prepared food, candy, dietary supplements, soft drinks, installation charges, and delivery charges to conform to the definitions proposed for the national Streamlined Sales Tax project.

ASSUMPTIONS AND METHODOLOGY: Part 1 of the bill provides the framework for future General Assembly action on the streamlined sales tax project and authorizes the Secretary

to participate in the Agreement. However, this portion of the bill does not make any substantive changes to existing law. As such, Part 1 has no immediate fiscal impact.

Part 2 of the bill changes definitions in the sales tax law to conform to those suggested in the national streamline project. Currently, the criteria for determining the state sales tax exemption status for food items is based on whether the item is "intended for home consumption", and whether the item can be purchased with federal food stamps. Part 2 of the legislation provides specific legal definitions for tax exempt food items. Some of these definitional changes will have a fiscal impact. At this point, Fiscal Research is unable to place an exact dollar amount of the revenue change without additional information from the North Carolina Department of Revenue. Conversations with the Department suggest that the definitional changes and their impact are as follows:

Candy: Under current law items are exempt from the state sales tax if they are considered food by the federal food stamp program. If an item can be purchased with food stamps it is exempt from state sales tax. These items remain subject to local tax. Currently almost all candy can be purchased with food stamps, and is therefore exempt from state tax. The bill defines candy as a category separate from food, and in doing so makes all of these items taxable at 6% (4% state, 2% local). While Fiscal Research cannot currently estimate the exact revenue impact of this item, it does appear it will cause a revenue increase.

Delivery Charges: At present most delivery charges are subject to state and local sales tax or use tax. Under current law, only in-state purchases with point of sale title transfers are exempt. In practical terms this means items sold in-state, but delivered by a third party carrier, such as a trucking company or the U.S. Postal service, are exempt. As a part of the bill, these delivery charges become taxable. The Department believes the fiscal impact of this change will be a very small revenue gain.

Dietary Supplements: Currently all dietary supplements except vitamin capsules are exempt from state tax. (Vitamin capsules cannot be purchased with food stamps). Adding this definition to the statutes effectively maintains the exemption for dietary supplements. It also continues the taxability of vitamins. As a result, no revenue change is expected as a result of this provision.

Food and Food Ingredients: This section has the effect of clarifies that food, other than prepared food (see below) continues to be exempt from state sales tax.

Soft Drink: This portion of the bill defines a soft drink as a "non-alcoholic beverage that contains natural or artificial sweeteners. Drinks that contain milk, milk products, milk substitutes, or are more than 50% juice are not soft drinks. The definitional change effectively makes soft drinks taxable at 6%. This will be a revenue gain for the state.

Prepared Food: Section 2:3 broadens the definition of prepared food. Under current law all bread, rolls, cakes, deli mixed cold salads, and fountain sodas are considered food and are exempt from state tax (assuming they are purchased in grocery stores, convenience stores, discount stores, etc.). The legislation redefines these items and makes them subject to state sales tax if the item is:

- sold heated or is heated by the retailer,
- mixed or combined by the retailer (such as bread or cold salads),
- sold with eating utensils provided by the retailer, including plates, eating utensils, glasses and cups, napkins, or straws.

This change effectively means that bread products and salads prepared by the retailer, on or off site, will be taxable. Items sold in a company owned day-old bread store (i.e. a Merrita Bread Outlet) and stand alone bakeries become taxable. Brand name bread and other mixed products sold by an unrelated retailer will continue to be exempt from state tax, as will bread and other mixed items produced by a separate subsidiary of a retailer. This will result in a revenue gain.

Vending Items and Installation Charges: The bill redefines these items but specifically continues their special tax status.

Other: While most of the bill will create revenue, a few of the changes will result in a revenue loss. Items that are currently taxable at 6%, but will become exempt from state tax are as follows:

- Crackers and cookies purchased at traditional gas stations (those without large coolers),
- Prepackaged food items (crackers and cookies) sold at a snack bar,
- Non-heated items sold at a concession stand.

While no exact estimate is available Fiscal Research believes the loss of these items from the state base will result in a net loss.

Part 2 of the bill also impacts local government. Under the legislation these definitional changes will also be made to the existing local sales tax statutes. However, the fiscal impact on locals will be much smaller because they already tax food.

The Department of Revenue believes the bill will be a net gain to the general fund and local governments. Fiscal Research cannot confirm that assumption because of limited data. Rulemaking and interpretation by the Department could also impact the fiscal effect.

Note: In future years North Carolina will have to examine and change some of its tax policies to continue participation in the Streamlined Sales Tax project.

LEGISLATIVE PROPOSAL #11

REVENUE LAWS TECHNICAL CHANGES

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 11:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE TO THE 2001 GENERAL ASSEMBLY

AN ACT TO MAKE TECHNICAL AND CLARIFYING 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: This proposal is effective when it becomes law.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

2001-LCX-9C(1.1)(z)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Revenue Laws Technical Changes. (Public)

Sponsors: Revenue Laws Study Committee.

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE REVENUE
3 LAWS AND RELATED STATUTES.
4 The General Assembly of North Carolina enacts:
5 **SECTION 1.** Section 10(h) of S.L. 2000-56, as amended by
6 Section 92A(c) of S.L. 2000-140, reads as rewritten:
7 "Section 10.(h) Technical Correction. - Section 9 of this act
8 becomes effective May 1, 1999, and applies to taxes paid on or
9 after that date. Section ~~12~~ 9 is repealed for taxes paid on or
10 after January 1, 2008."
11 **SECTION 2.** G.S. 105-111 is repealed.
12 **SECTION 3.** G.S. 105-113.85 reads as rewritten:
13 "**§ 105-113.85. Discount.**
14 Each wholesaler or importer who remits the excise taxes on malt
15 beverages or wine may deduct from the amount ~~payable by him~~
16 payable a discount of four percent (4%). This discount covers
17 losses due to spoilage and breakage, expenses incurred in
18 preparing the records and reports required by this Article, and
19 the expense of furnishing a bond."
20 **SECTION 4.** G.S. 105-129.3A(c) reads as rewritten:
21 "(c) Relationship With Enterprise Tiers. - For the purpose of
22 the wage standard requirement of G.S. ~~105-129.3(b),~~ 105-129.4,
23 the credit for investing in machinery and equipment allowed in
24 G.S. 105-129.9, and the credit for worker training allowed in

1 G.S. 105-129.11, a development zone is considered an enterprise
2 tier one area. For all other purposes, a development zone has the
3 same enterprise tier designation as the county in which it is
4 located."
5 **SECTION 5.** G.S. 105-129.4(b) reads as rewritten:
6 "(b) Wage Standard. -- A taxpayer is eligible for the credit
7 for creating jobs or the credit for worker training if the jobs
8 for which the credit is claimed meet the wage standard at the
9 time the taxpayer applies for the credit. No credit is allowed
10 for jobs not included in the wage calculation. A taxpayer is
11 eligible for the credit for investing in machinery and equipment,
12 the credit for research and development, or the credit for
13 investing in real property for a central office or aircraft
14 facility if the jobs at the location with respect to which the
15 credit is claimed meet the wage standard at the time the taxpayer
16 applies for the credit. In making the wage calculation, the
17 taxpayer must include any positions that were filled for at least
18 1600 hours during the immediately preceding taxable year even if
19 they are not filled at the time the taxpayer applies for the
20 credit.
21 Jobs meet the wage standard if they pay an average weekly wage
22 that is at least equal to the applicable percentage times the
23 applicable average weekly wage for the county in which the jobs
24 will be located, as computed by the Secretary of Commerce from
25 data compiled by the Employment Security Commission for the most
26 recent period for which data are available. The applicable
27 percentage for jobs located in an enterprise tier one area is one
28 hundred percent (100%). The applicable percentage for all other
29 jobs is one hundred ten percent (110%). The applicable average
30 weekly wage is the lowest of the following: (i) the average wage
31 for all insured private employers in the county, (ii) the average
32 wage for all insured private employers in the State, and (iii)
33 the average wage for all insured private employers in the county
34 multiplied by the county income/wage adjustment factor. The
35 county income/wage adjustment factor is the county income/wage
36 ratio divided by the State income/wage ratio. The county
37 income/wage ratio is average per capita income in the county
38 divided by the annualized average wage for all insured private
39 employers in the county. The State income/wage ratio is the
40 average per capita income in the State divided by the annualized
41 average wage for all insured private employers in the State."
42 **SECTION 6.** G.S. 105-129.8(a) reads as rewritten:
43 "(a) Credit. -- A taxpayer that meets the eligibility
44 requirements set out in G.S. 105-129.4, has five or more

full-time employees, and hires an additional full-time employee during ~~that~~ the taxable 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.Are

a 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~~ must be taken in equal installments over the four years following the taxable year in which the additional employee was hired and ~~shall be~~ is 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~~ are not 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~~ must be calculated as if the position had been created initially in the area to which it was moved."

SECTION 7. G.S. 105-129.13(c) reads as rewritten:

"(c) Certification. -- Before certifying that a development zone agency will undertake an improvement project in a development zone, the Secretary of Commerce must require the

1 agency to provide sufficient documentation to establish the
2 identity of the agency, the nature of the project, and that the
3 project is for a community development purpose and is located in
4 a development zone. The Secretary of Commerce shall not certify a
5 development zone agency under this section if the agency, any of
6 the agency's officers or directors, or any partner of the agency
7 has ever used any part of a contribution made under this section
8 for any purpose other than an improvement project."
9 **SECTION 8.** G.S. 105-129.19 reads as rewritten:
10 "**§ 105-129.19. (See Editor's note for repeal) Reports.**
11 The Department of Revenue ~~shall report to the Legislative~~
12 ~~Research Commission~~ must report to the Revenue Laws Study
13 Committee and to the Fiscal Research Division of the General
14 Assembly by May 1 of each year the following information for the
15 12-month period ending the preceding April 1:
16 (1) The number of taxpayers that claimed the credits
17 allowed in this Article.
18 (2) The cost of business property and renewable energy
19 property with respect to which credits were
20 claimed.
21 (2a) The location of each qualified North Carolina
22 low-income building with respect to which a
23 low-income housing credit was claimed.
24 (3) The total cost to the General Fund of the credits
25 claimed."
26 **SECTION 9.** G.S. 105-163.41(a) reads as rewritten:
27 "(a) Except as provided in subsection (d), if the amount of
28 estimated tax paid by a corporation during the taxable year is
29 less than the amount of tax imposed upon the corporation under
30 Article 4 of this Chapter for the taxable year, the corporation
31 ~~shall~~ must be assessed an additional tax as a penalty in an
32 amount determined by multiplying the amount of the underpayment
33 as determined under subsection (b), for the period of the
34 underpayment as determined under subsection (c), by the
35 percentage established as the rate of interest on assessments
36 under G.S. 105-241.1(i) that is in effect for the period of the
37 underpayment. For the purpose of this section, the amount of tax
38 imposed under Article 4 of this Chapter is the net amount after
39 subtracting the credits against the tax allowed by this Chapter
40 other than the credit allowed by this Article."
41 **SECTION 10.** G.S. 105-164.27A(d) reads as rewritten:
42 "(d) Revocation. -- A direct pay certificate is valid until
43 the holder returns it to the Secretary or it is revoked by the
44 Secretary. The Secretary may revoke a direct pay certificate if

1 the holder of the certificate does not file a sales and use tax
2 return on time, does not pay sales and use tax on time, or
3 otherwise fails to comply with the sales and use tax laws."
4 **SECTION 11.** G.S. 105-228.90 reads as rewritten:
5 "**§ 105-228.90. Scope and definitions.**
6 (a) Scope. -- This Article applies to Subchapters I, V, and
7 VIII of this Chapter, to the annual report filing requirements of
8 G.S. 55-16-22, to the primary forest product assessment levied
9 under Article 12 of Chapter 113A of the General Statutes, and to
10 inspection taxes levied under Article 3 of Chapter 119 of the
11 General Statutes.
12 (b) Definitions. -- The following definitions apply in this
13 Article:
14 (1) Charter school. -- A nonprofit corporation that has
15 a charter under G.S. 115C-238.29D to operate a
16 charter school.
17 (1a) City. -- A city as defined by G.S. 160A-1(2). The
18 term also includes an urban service district
19 defined by the governing board of a consolidated
20 city-county, as defined by G.S. 160B-2(1).
21 (1b) Code. -- The Internal Revenue Code as enacted as of
22 January 1, 2000, including any provisions enacted
23 as of that date which become effective either
24 before or after that date.
25 (1c) County. -- Any one of the counties listed in G.S.
26 153A-10. The term also includes a consolidated
27 city-county as defined by G.S. 160B-2(1).
28 (2) Department. -- The Department of Revenue.
29 (3) Electronic Funds Transfer. -- A transfer of funds
30 initiated by using an electronic terminal, a
31 telephone, a computer, or magnetic tape to instruct
32 or authorize a financial institution or its agent
33 to credit or debit an account.
34 (4) Reserved.
35 (5) Person. -- An individual, a fiduciary, a firm, an
36 association, a partnership, a limited liability
37 company, a corporation, a unit of government, or
38 another group acting as a unit. The term includes
39 an officer or employee of a corporation, a member,
40 a manager, or an employee of a limited liability
41 company, and a member or employee of a partnership
42 who, as officer, employee, member, or manager, is
43 under a duty to perform an act in meeting the
44 requirements of Subchapter I, V, or VIII of this

~~Chapter~~ Chapter, of G.S. 55-16-22, of Article 12 of Chapter 113A of the General Statutes, or of Article 3 of Chapter 119 of the General Statutes.

(6) Secretary. -- The Secretary of Revenue.

(7) Tax. -- A tax levied under Subchapter I, V, or VIII of this ~~Chapter~~ Chapter, the primary forest product assessment levied under Article 12 of Chapter 113A of the General Statutes, or an inspection tax levied under Article 3 of Chapter 119 of the General Statutes. Unless the context clearly requires otherwise, the terms "tax" and "additional tax" include penalties and interest as well as the principal amount.

(8) Taxpayer. -- A person subject to the tax or reporting requirements of Subchapter I, V, or VIII of this ~~Chapter~~ Chapter, of Article 12 of Chapter 113A of the General Statutes, or of Article 3 of Chapter 119 of the General Statutes."

SECTION 12. G.S. 105-256 is amended by adding a new subsection to read:

"(d) Other Requirements. -- The following requirements apply to the Secretary:

(1) Video Poker. -- G.S. 14-306.1(j) requires the Department of provide summary reports quarterly to the Joint Legislative Commission on Governmental Operations.

(2) Escheats. -- G.S. 116B-60(g) requires the Secretary to furnish information to the Escheat Fund on October 1 of each year."

SECTION 13. G.S. 105-449.60(41) reads as rewritten:

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

SECTION 14. G.S. 105-466(c) reads as rewritten:

"(c) Collection of the tax, and liability therefor, ~~shall~~ must begin and continue only on and after the first day of the month of either January or July, as set by the ~~board of county commissioner set by the~~ board of county commissioners in the resolution levying the 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

1 resolution. The county must give the Secretary at least 90 days
2 advance notice of a new tax levy or tax rate change."
3 **SECTION 15.** G.S. 20-79.7(b) reads as rewritten:
4 "(b) Distribution of Fees. -- The Special Registration Plate
5 Account and the Collegiate and Cultural Attraction Plate Account
6 are established within the Highway Fund. The Division must credit
7 the additional fee imposed for the special registration plates
8 listed in subsection (a) among the Special Registration Plate
9 Account (SRPA), the Collegiate and Cultural Attraction Plate
10 Account (CCAPA), and the Natural Heritage Trust Fund (NHTF),
11 which is established under G.S. 113-77.7, as follows:

	Special Plate	SRPA	CCAPA	NHTF
12				
13				
14	Animal Lovers	$10	$10	0
15	Ducks Unlimited	$10	$10	0
16	Goodness Grows	$10	~~$10~~ $15	0
17	Historical Attraction	$10	$20	0
18	In-State Collegiate Insignia	$10	$15	0
19	Kids First	$10	$15	0
20	Litter Prevention	$10	$10	0
21	March of Dimes	$10	$10	0
22	Olympic Games	$10	$15	0
23	Omega Psi Phi Fraternity	$10	$10	0
24	Out-of-state Collegiate Insignia	$10	0	$15
25	Personalized	$10	0	$10
26	Scenic Rivers	$10	$10	0
27	School Technology	$10	$10	0
28	Soil and Water Conservation	$10	$10	0
29	Special Olympics	$10	$10	0
30	State Attraction	$10	$20	0
31	Support Public Schools	$10	$10	0
32-33	University Health Systems of Eastern Carolina	$10	$15	0
34	Wildlife Resources	$10	$10	0
35	All other Special Plates	$10	0	0".

36 **SECTION 16.** G.S. 96-8(8) is recodified as G.S.
37 96-8(7c).
38 **SECTION 17.** G.S. 96-8 is amended by adding a new
39 subdivision to read:
40 "(7f) Internal Revenue Code. -- The Code as defined
41 in G.S. 105-228.90."
42 **SECTION 18.** G.S. 96-8(5)k. reads as rewritten:
43 "k. Notwithstanding any other provision of this
44 Chapter, any nonprofit organization or a group
45 of organizations (hereafter, where the words
46 "nonprofit organization" are used in this
47 Chapter, it shall include a group of nonprofit
48 organizations), ~~corporations,~~ any corporation,

1 or any community chest, fund, or foundation
2 ~~which are~~ that is organized and operated
3 exclusively for religious, charitable,
4 scientific, testing for public safety,
5 literary, or educational purposes, or for the
6 prevention of cruelty to children or ~~animals~~
7 ~~and which~~ animals, and that is exempt or may
8 be exempted from federal income tax under
9 section 501(c)(3) of the Internal Revenue ~~Code~~
10 ~~of 1954, provided such~~ Code, as long as the
11 employing unit for some portion of a day in
12 each of 20 different calendar weeks within the
13 current or preceding calendar year (whether or
14 not ~~such~~ the weeks are or were consecutive)
15 has or had in employment four or more
16 individuals (not necessarily simultaneously
17 and irrespective of whether the same
18 individuals are or were employed in each ~~such~~
19 week)."
20 **SECTION 19.** G.S. 96-8(6)k.12. reads as rewritten:
21 "12. Service in any calendar quarter in the
22 employ of any organization exempt from
23 income tax under the provisions of
24 section 501(a) of the Internal Revenue
25 Code ~~of 1954~~ (other than an organization
26 described in section 401(a) of ~~said~~ the
27 Internal Revenue ~~Code of 1954)~~ Code) or
28 under section 521 of the Internal Revenue
29 ~~Code of 1954,~~ Code, if the remuneration
30 for ~~such~~ the service is less than fifty
31 dollars ($50.00)."
32 **SECTION 20.** G.S. 96-8(6)k.16. reads as rewritten:
33 "16. Notwithstanding the provisions of G.S.
34 96-8(6)f.3. and 96-8(6)k.6., service
35 performed by an individual on a boat
36 engaged in catching fish or other forms
37 of aquatic animal life under the
38 arrangement with the owner or operator of
39 such boat pursuant to which: (A) ~~Such~~ The
40 individual does not receive any cash
41 remuneration (other than as provided in
42 subparagraph (B)), (B) ~~Such~~ The
43 individual receives a share of the boat's
44 (or the boats' in the case of a fishing

1 operation involving more than one boat)
2 catch of fish or other forms of aquatic
3 animal life or a share of the proceeds
4 from the sale of such catch, and (C) The
5 amount of ~~such~~ the individual's share
6 depends on the amount of the boat's (or
7 the boats' in the case of a fishing
8 operation involving more than one boat)
9 catch of fish or other forms of aquatic
10 animal life, but only if the operating
11 crew of ~~such~~ the boat (or each boat from
12 which the individual receives a share in
13 the case of a fishing operation involving
14 more than one boat) is normally made up
15 of fewer than 10 individuals. In order to
16 preserve the State's right to collect
17 State unemployment taxes for which a
18 credit against federal unemployment taxes
19 may be taken for contributions paid into
20 a State unemployment insurance fund, this
21 paragraph 16 ~~shall~~ does not apply, with
22 respect to any individual, to service
23 during any period for which an assessment
24 for federal unemployment taxes is made by
25 the Internal Revenue Service pursuant to
26 the Federal Unemployment Tax Act which
27 assessment becomes a final determination
28 (as defined by section 1313 of the
29 Internal Revenue ~~Code of 1954 as~~
30 ~~amended).~~ Code."
31 **SECTION 21.** G.S. 96-8(13)b. reads as rewritten:
32 "b. "Wages" shall not include:
33 1. Any payment made to, or on behalf of, an
34 employee or ~~his~~ the employee's
35 beneficiary from or to a trust ~~which~~ that
36 qualifies under the conditions set forth
37 in ~~Sections~~ sections 401(a)(1) and (2) of
38 the Internal Revenue ~~Code of 1954;~~ Code;
39 2. Any payment made to, or under, an annuity
40 plan which at the time of the payment
41 meets the requirements of ~~Sections~~
42 sections 401(a)(3), (4), (5) and (6) of
43 the Internal Revenue Code and exempt from
44 tax under ~~Section~~ section 501(a) of the

Internal Revenue Code at the time of the payment, unless the payment is made to an employee of the trust as remuneration for services rendered as an employee and not as beneficiary of the trust; or

3. Any payment made to, or on behalf of, an employee or his beneficiary under a Cafeteria Plan within the meaning of ~~Section~~ section 125 of the Internal Revenue Code."

SECTION 22. The first paragraph of G.S. 96-9(d) reads as rewritten:

"(d) Benefits paid to employees of nonprofit organizations shall be financed in accordance with the provisions of this paragraph. For the purposes of this paragraph, a nonprofit organization is an organization (or group of organizations) described in section 501(c)(3) of the ~~United States~~ Internal Revenue Code ~~of 1954 which~~ that is exempt from income tax under section 501(a) of ~~said~~ the Internal Revenue Code."

SECTION 23. G.S. 96-12(g)(3) reads as rewritten:

"(3) The individual may elect to have federal individual income tax deducted and withheld from the individual's payment of unemployment compensation at the amount specified in section 3402 of the Internal Revenue Code. ~~The term "Code" has the same meaning as defined in G.S. 105-228.90.~~"

SECTION 24. G.S. 96-12.01(a) is recodified as G.S. 91-12.01(a1).

SECTION 25. The first sentence of G.S. 96-12.01 is designated as subsection (a) of that section and reads as rewritten:

"(a) ~~Effective January 1, 1972, extended~~ Extended benefits shall be paid under this Chapter as ~~herein specified:~~ provided in this section."

SECTION 26. G.S. 96-12.01(a1)(11) reads as rewritten:

"(11) "State law" means the unemployment insurance law of any state approved by the United States Secretary of Labor under section 3304 of the Internal Revenue ~~Code of 1954.~~ Code."

SECTION 27. G.S. 116D-11(g) reads as rewritten:

"(g) University Improvement Bonds Fund. -- The proceeds of university improvement general obligation bonds and notes, including premium thereon, if any, except the proceeds of bonds the issuance of which has been anticipated by bond anticipation

1 notes or the proceeds of refunding bonds or notes, shall be
2 placed by the State Treasurer in a special fund to be designated
3 'University Improvement Bonds Fund'. Moneys in the University
4 Improvement Bonds Fund shall be used for the purposes set forth
5 in this Article.
6 Any additional moneys that may be received by means of a grant
7 or grants from the United States of America or any agency or
8 department thereof or from any other source to aid in financing
9 the cost of any university improvements authorized by this
10 Article may be placed by the State Treasurer in the University
11 Improvement Bonds Fund or in a separate account or fund and shall
12 be disbursed, to the extent permitted by the terms of the grant
13 or grants, without regard to any limitations imposed by this ~~act~~
14 ~~[the Michael K. Hooker Higher Education Facilities Financing Act,~~
15 ~~S. L. 2000-3].~~ <u>Article.</u>
16 The proceeds of university improvement general obligation bonds
17 and notes may be used with any other moneys made available by the
18 General Assembly for the making of university improvements,
19 including the proceeds of any other State bond issues, whether
20 previously made available or which may be made available after
21 the effective date of this Article. The proceeds of university
22 improvement bonds and notes shall be expended and disbursed under
23 the direction and supervision of the Director of the Budget. The
24 funds provided by this Article for university improvements shall
25 be disbursed for the purposes provided in this Article upon
26 warrants drawn on the State Treasurer by the State Controller,
27 which warrants shall not be drawn until requisition has been
28 approved by the Director of the Budget and which requisition
29 shall be approved only after full compliance with the Executive
30 Budget Act, Article 1 of Chapter 143 of the General Statutes."
31 **SECTION 28.** G.S. 116D-46(g) reads as rewritten:
32 "(g) Community College Bonds Fund. -- The proceeds of
33 community college general obligation bonds and notes, including
34 premium thereon, if any, except the proceeds of bonds the
35 issuance of which has been anticipated by bond anticipation notes
36 or the proceeds of refunding bonds or notes, shall be placed by
37 the State Treasurer in a special fund to be designated 'Community
38 College Bonds Fund'. Moneys in the Community College Bonds Fund
39 shall be used for the purposes set forth in this Article.
40 Any additional moneys that may be received by means of a grant
41 or grants from the United States of America or any agency or
42 department thereof or from any other source to aid in financing
43 the cost of any community college capital facilities authorized
44 by this Article may be placed by the State Treasurer in the

Community College Bonds Fund or in a separate account or fund and shall be disbursed, to the extent permitted by the terms of the grant or grants, without regard to any limitations imposed by this ~~act [the Michael K. Hooker Higher Education Facilities Financing Act, S. L. 2000-3].~~ Article.

The proceeds of community college general obligation bonds and notes may be used with any other moneys made available by the General Assembly for the making of grants to community colleges for capital facilities, including the proceeds of any other State bond issues, whether previously made available or which may be made available after the effective date of this Article. The proceeds of community college bonds and notes shall be expended and disbursed under the direction and supervision of the Director of the Budget. The funds provided by this Article for grants to community colleges shall be disbursed for the purposes provided in this Article upon warrants drawn on the State Treasurer by the State Controller, which warrants shall not be drawn until requisition has been approved by the Director of the Budget and which requisition shall be approved only after full compliance with the Executive Budget Act, Article 1 of Chapter 143 of the General Statutes."

SECTION 29. G.S. 143B-221 reads as rewritten:

"**§ 143B-221. Department of Revenue -- organization.**

The Department of Revenue shall be organized ~~initially to include the Property Tax Commission, the Division of Inheritance and Gift Tax, Division of Privilege License, Beverage and Cigarette Tax, Division of Corporate Income and Franchise Tax, Division of Individual Income Tax, Division of Sales and Use Tax, Division of Intangibles Tax, Division of Gasoline Tax, Division of Audit and Collection, Division of Accounts, Division of Planning and Processing, the Division of Tax Research, the Ad Valorem Tax Division, and such other divisions as may be established under the provisions of the Executive Organization Act of 1973.~~ in accordance with Article 1 of this Chapter.

The Secretary of Revenue may ~~create and appoint~~ create, appoint, and disband committees and councils to consult with and advise ~~him and the subordinate officers of~~ the Department on matters relating to the duties, responsibilities, or functions of the ~~Department; and he may disband any such committee or council at his pleasure.~~ Department."

SECTION 30. G.S. 160A-215.1(e) reads as rewritten:

"(e) The following definitions apply in this section:

(1) Vehicle. -- Any of the following:

1 a. A motor vehicle of the passenger type,
2 including a passenger van, minivan, or sport
3 utility vehicle.
4 b. A motor vehicle of the cargo type, including
5 cargo van, pickup truck, or truck with a
6 gross vehicle weight rating of 26,000 pounds
7 or less used predominantly in the
8 transportation of property for other than
9 commercial freight and that does not require
10 the operator to posses a commercial drivers
11 license.
12 c. A trailer or semitrailer with a gross vehicle
13 weight of 6,000 pounds or less.
14 (2) Short-term lease or rental. -- Defined in G.S.
15 105-187.1."
16 **SECTION 31.** This act is effective when it becomes law.

LEGISLATIVE PROPOSAL 11: Revenue Laws Technical Changes

BILL ANALYSIS

Committee: Revenue Laws
Date: January 3, 2001
Version: 2001-LCX-09C

Sponsor:
Analysis by: Martha H. Harris
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. The bill is effective when it becomes law.

Section	Explanation
1	Corrects incorrect section number in a session law
2	Repeals obsolete statute
3	Deletes gender-specific phrase
4	Corrects incorrect cross-reference
5	Clarifies that wage standard test must be measured based on all full-time jobs, including those subject to seasonal layoffs
6	Corrects incorrect word and conforms terminology
7	Adds missing words
8	Designates Revenue Laws Study Committee rather than Legislative Research Commission to receive Department of Revenue report on tax credits
9	Clarifies that corporate estimated tax payments are based on net tax due minus allowable credits
10	Supplies missing word
11	Adds references in Chapter 105 to the timber tax levied in Chapter 113A, which is collected by the Department of Revenue
12	Adds cross-references to reporting requirements codified outside of Chapter 105 of the General Statutes
13	Corrects misspelling
14	Deletes duplicate phrase
15	Corrects distribution amounts of $25 license fee
16 - 26	Conforms Employment Security law's references to Internal Revenue Code, clarifies wording, and conforms structure of G.S. 96-12.01
27 - 28	Clarifies internal cross-references in Chapter 116D (Higher Education Bonds)
29	Updates statute describing organization of the Department of Revenue
30	Supplies missing word
31	Effective Date

LEGISLATIVE PROPOSAL #12

SIMPLIFY TAXES ON TELECOMMUNICATIONS

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 12:

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, 2002, and applies to taxable services reflected on bills dated on or after January 1, 2002.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

S/H D

01-RBXZ-100
THIS IS A DRAFT

Short Title: Simplify Taxes on Telecommunications. (Public)

Sponsors:

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO SIMPLIFY THE COLLECTION OF TELECOMMUNICATIONS TAXES.
3 The General Assembly of North Carolina enacts:
4 Section 1. G.S. 105-164.3 is amended by adding the
5 following new subdivisions in the correct alphabetical order
6 to read:
7 "**§ 105-164.3. Definitions.**
8 The following definitions apply in this Article, except when
9 the context clearly indicates a different meaning:
10 . . .
11 (8b) Mobile telecommunications service. -- A radio
12 communication service carried on between mobile
13 stations or receivers and land stations, and by
14 mobile stations communicating among themselves,
15 and include all of the following:
16 (a) Both one-way and two-way radio
17 communication services.
18 (b) A mobile service which provides a regularly
19 interacting group of base, mobile,
20 portable, and associated control and relay
21 stations for private one-ay or two-way land

1 mobile radio communications by eligible
2 users over designated areas of operation.
3 (c) Any service for which a federal license is
4 required in a personal communications
5 service.
6 ....
7 (11a) Prepaid telephone calling arrangement. -- A
8 right that authorizes the exclusive
9 purchase of telecommunications service;
10 must be paid for in advance; enables the
11 origination of calls by means of an access
12 number, authorization code, or another
13 similar means, regardless of whether the
14 access number or authorization code is
15 manually or electronically dialed; and is
16 sold in units or dollars whose number or
17 dollar value declines with use and is known
18 on a continuous basis.
19 . . .
20 (16b) Service address. -- The location of the
21 telecommunications equipment from which a
22 customer originates or receives
23 telecommunications service. In the case of
24 mobile telecommunications service, maritime
25 systems, third-number calls, calling card
26 calls, and other similar services for which
27 the location of the equipment cannot be
28 determined as part of the billing process,
29 the telecommunications service provider may
30 determine the location of the equipment
31 based upon the customer's telephone number,
32 the mailing address to which the bills are
33 sent, or a street address provided by the
34 customer if the street address is within
35 the licensed service area of the service
36 provider. In the case of
37 telecommunications service paid through a
38 payment mechanism that does not relate to
39 the location of the equipment, such as a
40 bank, travel, debit, or credit card, the
41 service address is the address of the
42 central office as determined by the area
43 code and the first three digits of the
44 seven digit originating telephone number.

. . .

(21a) Telecommunications service. -- The transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points, by or through any electronic, radio, satellite, optical, microwave, or other medium, regardless of the protocol used for the transmission, conveyance, or routing. The term includes mobile telecommunications service and vertical services. Vertical services are switch-based services offered in connection with a telecommunications service, such as call forwarding services, caller ID services, and three-way calling services."

Section 2. G.S. 105-164.3(8c) is recodified as G.S. 105-164.3(8d) and G.S. 105-164.3(8b) is recodified as G.S. 105-164.3(8c).

Section 3. G.S. 105-164.3(25) is repealed.

Section 4. 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 5. 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 6. 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 mobile telecommunications service, the customer's service address, if no tangible personal property is shipped to the customer as part of the transaction."

Section 7. 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.**

1 (a) General. -- The gross receipts derived from providing
2 telecommunications service in this State are taxed at the rate
3 set in G.S. 105-164.4(a)(4c). Mobile telecommunications
4 service is provided in this State if the customer's service
5 address is in this State and the call originates or terminates
6 in this State.
7 (b) Included in Gross Receipts. -- Gross receipts derived
8 from telecommunications service include the following:
9 (1) Receipts from local, intrastate, interstate,
10 toll, private, and mobile telecommunications
11 service.
12 (2) Charges for directory assistance, directory
13 listing that is not yellow-page classified
14 listing, call forwarding, call waiting, three-
15 way calling, caller ID, and other similar
16 services.
17 (3) Customer access line charges billed to
18 subscribers for access to the intrastate or
19 interstate interexchange network.
20 (4) Charges billed to a pay telephone provider who
21 uses the telecommunications service to provide
22 pay telephone service.
23 (c) Excluded From Gross Receipts. -- Gross receipts
24 derived from telecommunications service do not include any of
25 the following:
26 (1) Charges for telecommunications services that are
27 a component part of or are integrated into a
28 telecommunications service that is resold.
29 Examples of services that are resold include
30 carrier charges for access to an intrastate or
31 interstate interexchange network,
32 interconnection charges paid by a provider of
33 mobile telecommunications service, and charges
34 for the sale of unbundled network elements. An
35 unbundled network element is a network element,
36 as defined in 47 U.S.C. § 153(29), to which
37 access is provided on an unbundled basis
38 pursuant to 47 U.S.C. § 251(c)(3).
39 (2) Telecommunications services that are resold as
40 part of a prepaid telephone calling arrangement.
41 (3) 911 charges imposed under G.S. 62A-4 or G.S.
42 62A-23 and remitted to the Emergency Telephone
43 System Fund under G.S. 62A-7 or the Wireless
44 Fund under G.S. 62A-24.

1 (4) Allowable surcharges imposed to recoup
2 assessments for the Universal Service Fund.
3 (5) Receipts of a pay telephone provider from the
4 sale of pay telephone service.
5 (6) Charges for commercial, cable, mobile,
6 broadcast, or satellite video or audio service
7 unless the service provides two-way
8 communication, other than the customer's
9 interactive communication in connection with the
10 customer's selection or use of the video or
11 audio service.
12 (7) Paging service, unless the service provides two-
13 way communication.
14 (8) Charges for telephone service made by a hotel,
15 motel, or another entity whose gross receipts
16 are taxable under G.S. 105-164.4(a)(3) when the
17 charges are incidental to the occupancy of the
18 entity's accommodations.
19 (9) Receipts from the sale, installation,
20 maintenance, or repair of tangible personal
21 property.
22 (10) Directory advertising and yellow-page classified
23 listings.
24 (11) Voicemail services.
25 (12) Information services. An information service is
26 a service that can generate, acquire, store,
27 transform, process, retrieve, use, or make
28 available information through a communications
29 service. Examples of an information service
30 include an electronic publishing service and a
31 Web hosting service.
32 (13) Internet access service, electronic mail
33 service, electronic bulletin board service, or
34 similar on-line services.
35 (14) Billing and collection services.
36 (15) Charges for bad checks or late payments.
37 (d) Bundled Services. -- When a taxable telecommunications
38 service is bundled with a service that is not taxable, the tax
39 applies to the gross receipts from the taxable service in the
40 bundle as follows:
41 (1) If the service provider offers all the services
42 in the bundle on an unbundled basis, tax is due
43 on the unbundled price of the taxable service,
44 less the discount resulting from the bundling.

1 The discount for a service as the result of
2 bundling is the proportionate price decrease of
3 the service, determined on the basis of the
4 total unbundled price of all the services in the
5 bundle compared to the bundled price of the
6 services.
7 (2) If the service provider does not offer one or
8 more of the services in the bundle on an
9 unbundled basis, tax is due on the taxable
10 service based on a reasonable allocation of
11 revenue to that service. If the service
12 provider maintains an account for revenue from a
13 taxable service, the service provider's
14 allocation of revenue to that service for the
15 purpose of determining the tax due on the
16 service must reflect its accounting allocation
17 of revenue to that service.
18 (e) Interstate Private Line. -- The gross receipts derived
19 from interstate private telecommunications service are taxable
20 as follows:
21 (1) One hundred percent (100%) of the charge imposed
22 at each channel termination point in this State.
23 (2) One hundred percent (100%) of the charge imposed
24 for the total channel mileage between each
25 channel termination point in this State.
26 (3) Fifty percent (50%) of the charge imposed for
27 the total channel mileage between the first
28 channel termination point in this State and the
29 nearest channel termination point outside this
30 State.
31 (f) Call Center Cap. -- The gross receipts tax on interstate
32 telecommunications service that originates outside this State,
33 terminates in this State, and is provided to a call center
34 that has a direct pay certificate issued by the Department
35 under G.S. 105-164.27 may not exceed fifty thousand dollars
36 ($50,000) a calendar year. This cap applies separately to
37 each legal entity.
38 (g) Credit. -- A taxpayer who pays a tax legally imposed by
39 another state on a telecommunications service taxable under
40 this section is allowed a credit against the tax imposed in
41 this section.
42 (h) Definitions. -- The following definitions apply in this
43 section:
44 (1) Call center. -- Defined in G.S. 105-164.27.

1 (2) Interstate telecommunications service. --
2 Telecommunications service that originates or
3 terminates in this State, but does not both
4 originate and terminate in this State, and is
5 charged to a service address in this State.
6 (3) Intrastate telecommunications service. --
7 Telecommunications service that both originates
8 and terminates in this State.
9 (4) Local telecommunications service. --
10 Telecommunications service that provides access
11 to a local telephone network and enables a user
12 to communicate with substantially everyone who
13 has a telephone or radiotelephone station that
14 is part of the local telephone network.
15 (5) Mobile telecommunications service. -- Defined in
16 G.S. 105-164.3."
17 (6) Private telecommunications service. --
18 Telecommunications service that entitles a
19 subscriber of the service to exclusive or
20 priority use of a communications channel or
21 group of channels.
22 (7) Service address. -- Defined in G.S. 105-164.3.
23 (8) Telecommunications service. -- Defined in G.S.
24 105-164.3.
25 (9) Toll telecommunications service. -- Any of the
26 following:
27 a. A service for which there is a toll charge
28 that varies in amount with the distance or
29 elapsed transmission time of each
30 individual communication.
31 b. A service that entitles the subscriber,
32 upon payment of a periodic charge,
33 determined as a flat amount or on the basis
34 of total elapsed transmission time, to an
35 unlimited number of communications to or
36 from all or a substantial portion of those
37 who have a telephone or radiotelephone
38 station in an area outside the local
39 telephone network."
40 Section 8. G.S. 105-164.16(c) reads as rewritten:
41 "(c) Sales Tax on ~~Utility Services.~~ Electricity and
42 Telecommunications. -- A return for taxes levied under G.S.
43 105-164.4(a)(4a) and G.S. 105-164.4(a)(4c) is due ~~quarterly or~~
44 ~~monthly as specified in this subsection. A utility that is~~

1 ~~allowed to pay tax under G.S. 105-120 on a quarterly basis~~
2 ~~shall file a quarterly return. All other utilities shall file~~
3 ~~a monthly return. A quarterly return is due by the last day of~~
4 ~~the month following the quarter covered by the return. A~~
5 monthly. The monthly return is due by the last day of the
6 month following the month in which the taxes accrue, except
7 the return for taxes that accrue in May. A return for taxes
8 that accrue in May is due by June 25.
9 A ~~utility~~ retailer that is required to file a monthly return
10 may file an estimated return for the first month, the second
11 month, or both the first and second months in a quarter. A
12 ~~utility~~ retailer is not subject to interest on or penalties
13 for an underpayment submitted with an estimated monthly return
14 if the ~~utility~~ retailer timely pays at least ninety-five
15 percent (95%) of the amount due with a monthly return and
16 includes the underpayment with the ~~company's~~ retailer's return
17 for the third month in the same quarter."
18 Section 9. G.S. 105-164.20 reads as rewritten:
19 "**§ 105-164.20. Cash or accrual basis of reporting.**
20 Any retailer, except a ~~utility,~~ retailer who sells
21 electricity or telecommunications service, may report sales on
22 either the cash or accrual basis of accounting upon making
23 application to the Secretary for permission to use the basis
24 selected. Permission granted by the Secretary to report on a
25 selected basis continues in effect until revoked by the
26 Secretary or the taxpayer receives permission from the
27 Secretary to change the basis selected. A ~~utility~~ retailer who
28 sells electricity or telecommunications service must report
29 its sales on an accrual basis. A sale ~~by a utility~~ of
30 electricity or ~~intrastate telephone~~ telecommunications service
31 is considered to accrue when the utility bills its customer
32 for the sale."
33 Section 10. G.S. 105-164.27A reads as rewritten:
34 "**§ 105-164.27A. Direct pay ~~certificate.~~ permit.**
35 (a) ~~Requirements.~~ Direct Pay Permit for Tangible Personal
36 Property. -- A direct pay permit for tangible personal
37 property authorizes its holder to purchase any tangible
38 personal property without paying tax to the seller and
39 authorizes the seller to not collect any tax on a sale to the
40 permit holder. A person who purchases tangible personal
41 property under a direct pay permit issued under this
42 subsection is liable for use tax due on the purchase. The tax
43 is payable when the property is placed in use. A direct pay

1 permit issued under this subsection does not apply to taxes
2 imposed under G.S. 105-164.4(a)(1f) or G.S. 105-164.4(a)(4a).
3 A person who purchases tangible personal property whose tax
4 status cannot be determined at the time of the purchase
5 because of one of the reasons listed below may apply to the
6 Secretary for a direct pay permit for tangible personal
7 property:
8 (1) The place of business where the property will be
9 used is not known at the time of the purchase
10 and a different tax consequence applies
11 depending on where the property is used.
12 (2) The manner in which the property will be used is
13 not known at the time of the purchase and one or
14 more of the potential uses is taxable but others
15 are not taxable.
16 (b) ~~Procedure. -- An application for a direct pay~~
17 ~~certificate permit must be made on a form provided by the~~
18 ~~Secretary and contain the information required by the~~
19 ~~Secretary. The Secretary may grant the application if the~~
20 ~~Secretary finds that the applicant complies with the sales and~~
21 ~~use tax laws and that the applicant's compliance burden will~~
22 ~~be greatly reduced by use of the certificate.~~
23 ~~(c) Effect. -- A direct pay certificate authorizes its~~
24 ~~holder to purchase any tangible personal property without~~
25 ~~paying tax to the seller and authorizes the seller to not~~
26 ~~collect any tax on a sale to the certificate holder. A person~~
27 ~~who purchases tangible personal property under a direct pay~~
28 ~~certificate is liable for use tax due on the purchase. The~~
29 ~~tax is payable when the property is placed in use. A direct~~
30 ~~pay certificate does not apply to taxes imposed under G.S.~~
31 ~~105-164.4(a)(1f) or G.S. 105-164.4(a)(4a).~~
32 (b) Direct Pay Permit for Telecommunications Service. -- A
33 direct pay permit for telecommunications service authorizes
34 its holder to purchase telecommunications service without
35 paying tax to the seller and authorizes the seller to not
36 collect any tax on a sale to the permit holder. A person who
37 purchases telecommunications service under a direct pay permit
38 must file a return and pay the tax due monthly to the
39 Secretary. A direct pay permit issued under this subsection
40 does not apply to any tax other than the tax on
41 telecommunications service.
42 A call center that purchases interstate telecommunications
43 service that originates outside this State and terminates in
44 this State may apply to the Secretary for a direct pay permit

1 for telecommunications service. A call center is a business
2 that is primarily engaged in providing support services to
3 customers by telephone to support products or services of the
4 business. A business is primarily engaged in providing
5 support services by telephone if at least sixty percent (60%)
6 of its calls are incoming.
7 (c) Application. -- An application for a direct pay permit
8 must be made on a form provided by the Secretary and contain
9 the information required by the Secretary. The Secretary may
10 grant the application if the Secretary finds that the
11 applicant complies with the sales and use tax laws and that
12 the applicant's compliance burden will be greatly reduced by
13 use of the ~~certificate.~~ permit.
14 (d) Revocation. -- A direct pay ~~certificate~~ permit is valid
15 until the holder returns it to the Secretary or it is revoked
16 by the Secretary. The Secretary may revoke a direct pay
17 ~~certificate~~ permit if the holder of the ~~certificate~~ permit
18 does not file a sales and use tax return on time, does not pay
19 sales and use on time, or otherwise fails to comply with the
20 sales and use tax laws."
21 Section 11. Part 8 of Article 5 of Chapter 105 of
22 the General Statutes is amended by adding a new section to
23 read:
24 "**§ 105-164.44F. Distribution of part of telecommunications**
25 **taxes to cities.**
26 Within 75 days after the end of each calendar quarter, the
27 Secretary must distribute to the cities twelve percent (12%)
28 of the net proceeds of the taxes imposed by G.S. 105-
29 164.4(a)(4c) on telecommunications service. The Secretary
30 must distribute this amount among the cities on a per capita
31 basis according to the most recent annual population estimates
32 certified to the Secretary by the State Planning Officer. A
33 city incorporated on or after January 1, 2000, may not receive
34 a distribution under this section unless it meets both of the
35 following requirements:
36 (1) It must be eligible to receive funds under G.S.
37 136-41.2.
38 (2) A majority of the mileage of its streets must be
39 open to the public."
40 Section 12. G.S. 105-116(d) reads as rewritten:
41 "(d) Distribution. -- ~~Part of the taxes imposed by this~~
42 ~~section on electric power companies, natural gas companies,~~
43 ~~and regional natural gas districts is distributed to cities~~
44 ~~under G.S. 105-116.1.~~ Within 75 days after the end of each

1 calendar quarter, the Secretary must distribute to the cities
2 part of the tax proceeds from the gross receipts of an
3 electric power company derived within the city. The amount to
4 be distributed to a city is three and nine hundredths percent
5 (3.09%) of the gross receipts derived within the city."
6 Section 13. G.S. 105-116.1 is repealed.
7 Section 14. G.S. 105-120 is repealed.
8 Section 15. G.S. 105-467 is amended by adding a new
9 subdivision to read:
10 "(6) The sales price of prepaid telephone calling
11 arrangements taxed as tangible personal property
12 under G.S. 105-164.4(a)(4d)."
13 Section 16. The first paragraph of Section 4 of
14 Chapter 1096 of the 1967 Session Laws, as amended, is amended
15 as follows:
16 (1) By deleting the word "and" before subdivision
17 (5).
18 (2) By changing the period at the end of subdivision
19 (5) to a semicolon and adding the word "and".
20 (3) By adding a new subdivision to read:
21 "(6) The sales price of prepaid telephone calling
22 arrangements taxed as tangible personal property
23 under G.S. 105-164.4(a)(4d)."
24 Section 17.(a) Hold-Harmless. -- For distributions
25 made in calendar quarters beginning on or after April 1, 2002,
26 the combined amount distributed to a city under G.S. 105-116,
27 105-164.44F, and 105-187.44 is subject to the following
28 conditions:
29 (1) The amount distributed to a city may not exceed
30 the city's overall benchmark amount until each
31 city receives an amount equal to its overall
32 benchmark amount.
33 (2) The amount distributed to a city may not be less
34 than the city's overall benchmark amount.
35 Section 17.(b) Calculation. -- Each quarter, the
36 Secretary of Revenue must determine a city's overall benchmark
37 amount and the amount it would receive under G.S. 105-116,
38 105-164.44F, and 105-187.44, as modified by S.L. 1998-22,
39 Section 14 and S.L. 2000-140, Section 85, if not for the
40 redistribution required by this section. The Secretary must
41 identify those cities whose distribution amounts under these
42 three statutes are less than their overall benchmark amounts
43 and must determine the total dollar amount of the shortfall.
44 The Secretary must reduce the amount to be distributed to

1 those cities whose distribution amount under those statutes
2 exceeds their overall benchmark amount by the total dollar
3 amount of the shortfall determined for that quarter in
4 proportion to each city's excess. However, in no event may a
5 city's distribution amount be reduced below its overall
6 benchmark amount. The Secretary must redistribute these
7 monies to the cities whose distribution amounts under the
8 three statutes are less than their overall benchmark amounts
9 in proportion to each city's shortfall. In any quarter that a
10 city does not have a prior year's distribution for the
11 corresponding quarter in the preceding fiscal year, that city
12 is excluded from the redistribution required under this
13 section for that quarter. In that case, the city will receive
14 the amount it is entitled to receive under G.S. 105-116, 105-
15 164.44F, and 105-187.44.
16 Section 17.(c) Definition. -- As used in this
17 section, the term "overall benchmark amount" means the sum of
18 the following two amounts:
19 (1) The amount distributed to the city under
20 repealed G.S. 105-116.1 in the same calendar
21 quarter of the last year in which the city
22 received the distribution under that statute.
23 (2) The city's piped natural gas benchmark amount
24 for that same quarter, as determined under S.L.
25 1998-22, Section 14, as amended by S.L. 2000-
26 140, Section 18.
27 Section 17.(d) Report. -- The Department of Revenue
28 must report to the Revenue Laws Study Committee by October 1,
29 2003, on the effect of the changes made by this act on the
30 amounts distributed to cities. The Department must include
31 in its report any adjustments to city distributions
32 recommended by the Department. The Department must consult
33 with the North Carolina League of Municipalities in developing
34 its recommendations.
35 Section 18. G.S. 153A-152 reads as rewritten:
36 "**§ 153A-152. Privilege license taxes.**
37 <u>(a) Authority. --</u> A county may levy privilege license taxes
38 on trades, occupations, professions, businesses, and
39 franchises to the extent authorized by Article 2 of Chapter
40 105 of the General Statutes and any other acts of the General
41 Assembly. A county may levy privilege license taxes to the
42 extent formerly authorized by the following sections of
43 Article 2 of Chapter 105 of the General Statutes before they
44 were repealed:

1 G.S. 105-50 Pawnbrokers.
2 G.S. 105-53 Peddlers, itinerant merchants, and
3 specialty market operators.
4 G.S. 105-55 Installing elevators and automatic
5 sprinkler systems.
6 G.S. 105-58 Fortune tellers, palmists, etc.
7 G.S. 105-65 Music machines.
8 G.S. 105-66.1 Electronic video games.
9 G.S. 105-80 Firearms dealers and dealers in other
10 weapons.
11 G.S. 105-89 Automobiles, wholesale supply dealers and
12 service stations.
13 G.S. 105-89.1 Motorcycle dealers.
14 G.S. 105-90 Emigrant and employment agents.
15 G.S. 105-102.5 General business license.
16 (b) Telecommunications Restriction. -- A county may not
17 impose a license, franchise, or privilege tax on a company
18 taxed under G.S. 105-164.4(a)(4c)."
19 Section 19. G.S. 160A-211 is amended by adding a new
20 subsection to read:
21 "(d) Telecommunications Restriction. -- A city may not
22 impose a license, franchise, or privilege tax on a company
23 taxed under G.S. 105-164.4(a)(4c)."
24 Section 20. Pursuant to G.S. 62-31 and G.S. 62-32,
25 the Utilities Commission must lower the rate set for local
26 telecommunications service to reflect the repeal of G.S. 105-
27 120 and the resulting liability of local telecommunications
28 companies for the tax imposed under G.S. 105-122.
29 Section 21. The Revenue Laws Study Committee shall
30 recommend any changes necessary to this act to conform with
31 the federal Mobile Telecommunications Sourcing Act to the 2002
32 Session of the 2001 General Assembly.
33 Section 22. This act becomes effective January 1,
34 2002, and applies to taxable services reflected on bills dated
35 on or after January 1, 2002. Section 17 expires on July 1,
36 2004.

BILL ANALYSIS

LEGISLATIVE PROPOSAL 12:
Simplify the Tax on Telecommunications

Committee: Revenue Laws
Date: December 14, 2000
Version: 01-RBXZ-100

Introduced by:
Summary by: Cindy Avrette
Committee Counsel

SUMMARY: Proposal 01-RBXZ-100 is virtually identical to the proposal recommended by the Revenue Laws Study Committee to the 2000 Session of the General Assembly, Senate Bill 1320. Proposal 01-RBXZ-100 would make several changes to the tax laws to simplify the tax on telecommunications. It would tax prepaid telephone calling cards at the point of sale, apply one tax at one rate to all telecommunications services, including interstate telecommunications, establish a sourcing rule for wireless telecommunications, and eliminate 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 7 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", and "wireless telecommunications service". Section 2 makes conforming changes to enable the definitions to be placed in G.S. 105-164.3 in the correct alphabetical order.

Section 3 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 4, 8, and 9)

Section 5 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 6 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 7 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 10)

Section 11 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 12 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 13 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 14 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 15 and 16 make conforming changes to the local sales tax statutes. It puts the prepaid telephone calling arrangements in the local sales tax base.

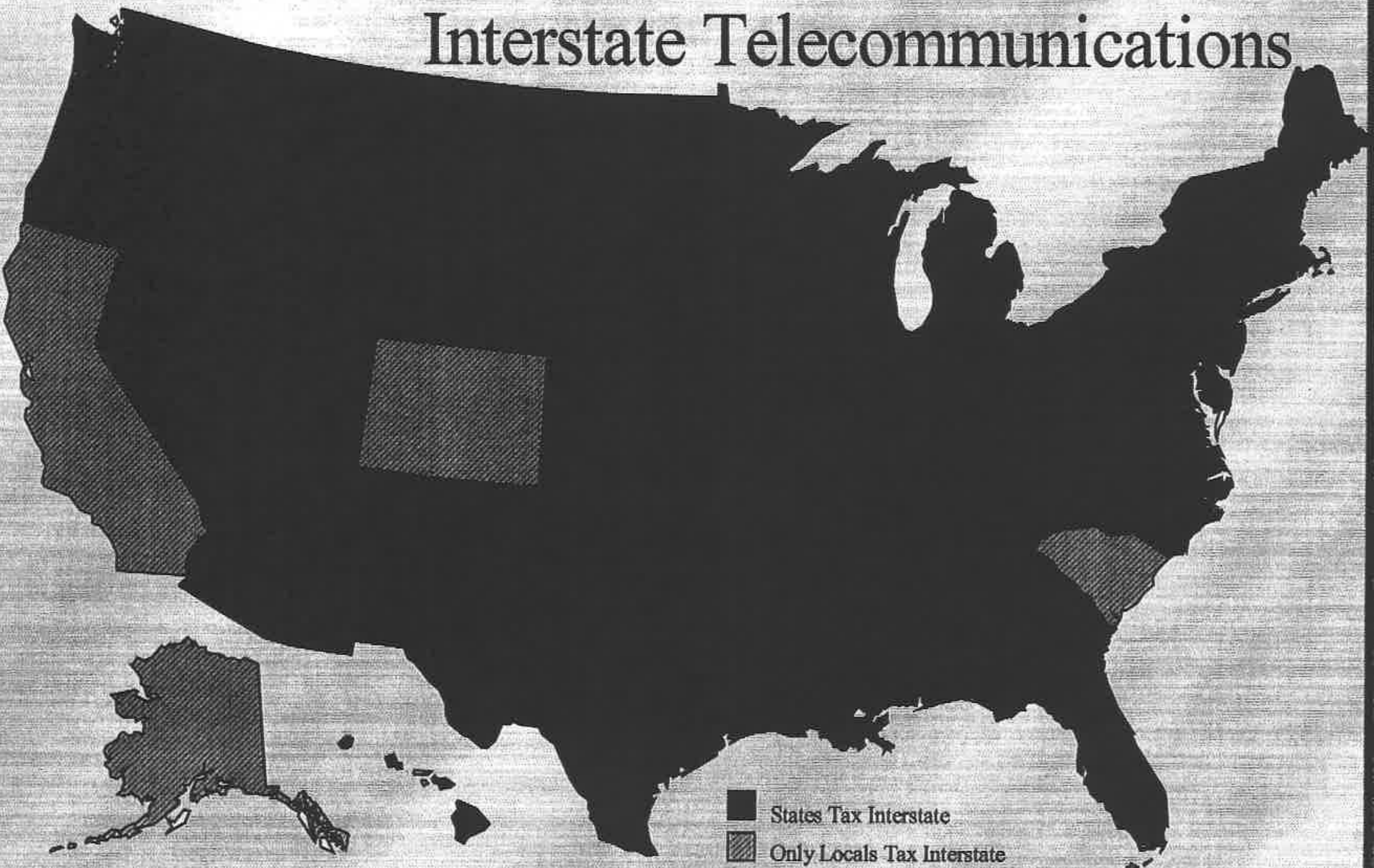
Section 17 protects local revenues from drops resulting from unanticipated shifts in the amounts distributed. This shifting can occur as a result of the changes in the taxation of telecommunications and the new distribution formula for these taxes. It envisions that the Department will report the effect of the changes and that any needed adjustments can then be made before July 1, 2004. A similar provision was included in the law that provided a simple, uniform tax structure for piped natural gas.

Sections 18 and 19 preserve the prohibition on county and city taxes on telecommunications services that is now contained in G.S. 105-120(d).

Section 20 requires the Utilities Commission to reduce the rate set for local telecommunications service to reflect the repeal of G.S. 105-120 and to clarify that the Commission should consider the imposition of the general franchise tax liability on local telecommunications companies. 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 21 directs the Revenue Laws Study Committee to recommend to the 2002 Session of the General Assembly any changes necessary to conform North Carolina's tax laws with the federal Mobile Telecommunications Sourcing Act.

Section 22 provides that this proposal becomes effective January 1, 2002.


States Taxing
Interstate Telecommunications
States Tax Interstate
Only Locals Tax Interstate
Interstate is Not Taxed

FISCAL ANALYSIS MEMORANDUM

DATE: January 4, 2001

TO: Revenue Laws Study Committee

FROM: Richard Bostic, Linda Millsaps
Fiscal Research Division

RE: Legislative Proposal 12
Simplify Taxes on Telecommunications

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
4.5% tax rate					
Coin operated phones					
Prepaid calling cards	No estimate available				
EXPENDITURES					
Department of Revenue	Not yet determined				

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

EFFECTIVE DATE: The bill is effective January 1, 2002 and applies to taxable services reflected on bills dated on or after January 1, 2002. Section 16 (tax distribution to cities) expires on July 1, 2004.

BILL SUMMARY: This bill attempts to simplify the collection of telecommunications taxes by (1) combining multiple tax rates into one uniform rate equal to 4.5%, (2) broadening the tax base by eliminating exemptions for interstate calls and telephone membership corporations, (3) taxing prepaid phone cards at the point of sale instead of at the point of use, and (4) eliminating complicated distribution formulas for local revenue sharing.

ASSUMPTIONS AND METHODOLOGY:

Uniform Rate

Section 4 of the bill establishes a 4.5% tax rate on gross receipts derived from all telecommunications. This new rate replaces the current tax structure for telecommunications that is illustrated below.

Type of Call	State Sales Tax	State Franchise Tax
Most Local	3.00%	3.22%
Local Coin Pay Phone	0%	0%
Toll	6.50%	0%
Intrastate	6.50%	0%
Interstate	0%	0%

The 4.5% tax rate was chosen as a revenue neutral rate for the General Fund. The first attempt to set this rate failed when telecommunications companies serving North Carolina refused to answer a survey sent out jointly by the Department of Revenue and the Fiscal Research Division of the General Assembly. The telecommunication companies feared that answering the survey would reveal valuable market share data. Without industry data, a revenue neutral tax rate was computed using tax collections and an estimate of interstate calls. Department of Revenue records show the following tax collections for FY 1998-99:

3% sales tax	$76,400,000
6.5% sales tax	55,287,550
3.22% franchise tax	79,658,103
	$211,345,653

Based on 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.

City Distribution

Currently cities receive 3.09% of the 3.22% gross receipts tax assessed on calls made within their city limits. Sections 10 through 12 of the bill replace this allocation with a 12% share of the total receipts from the new 4.5% tax. The bill also simplifies the complex distribution formula to cities by instituting a per capita distribution. The bill has a hold-harmless clause that guarantees cities receive no less than they did the previous year. During the first 6 months of FY 1999-00, cities received $13.1 million in telephone franchise tax distributions. A 12% share of the proposed 4.5% tax rate will yield $13.7 million.

Prepaid Phone Cards
Section 5 of the bill subjects prepaid phone cards to the 6% state and local sales tax (6.5% Mecklenburg) at the point of sale. As of 1999, 28 states and the District of Columbia taxed prepaid calling cards with the point of sale method. Currently, North Carolina taxes the phone cards when used by the consumer. Since the Department of Revenue does not track the tax paid on the use of calling cards, it is difficult to determine the revenue impact of the change in tax methods. The firm Atlantic-ACM estimated that the 1998 U.S. retail market for prepaid calling cards was $3.2 billion. If North Carolina's market share is equal to its share of the US population (2.8%), then $89.6 million in calling cards were sold in North Carolina in 1998. If used for interstate calls, the state would not have received any tax. If used for intrastate calls, then those minutes would have been taxed at 6.5%. The state receives no tax on cards that are lost or not fully utilized for the full face value of the card. At a minimum, tax at the point of sale should be a break-even or a positive gain for the state. If the 1998 sales had been taxed at the point of sale, the state would have earned $3,584,000 from a 4% sales tax and local governments would have earned $1,792,000.

Coin Operated Phones
Section 6 of the bill includes in taxable gross receipts the customer access line charges billed to pay phone companies. The North Carolina Utilities Commission Public Staff estimates that there are approximately 44,000 pay phones in the state. According to the North Carolina Payphone Association, the average access line charge is between $45 and $50 a month. Assuming $50 a month for 44,000 pay phones, then the taxable receipts equal $26.4 million. If a 4.5% tax rate is imposed on $26.4 million in receipts, then the General Fund will earn $1,188,000 from the line charges. This will be addition to the taxes now paid by the payphone companies on coin calls.

Call Centers

Section 9 caps the telecommunications tax liability of call centers at $50,000 annually. The cap applies to a user that purchases interstate telecommunications services that originate outside North Carolina but terminates in the state, and has a direct pay certificate issued by the Department of Revenue. No reliable information is available to Fiscal Research on the amount of calls made by these centers or the tax loss associated with a cap.

Franchise Tax
Section 13 repeals the 3.22% gross receipts franchise tax on telecommunications companies. By doing so it places telecommunications companies under the general business franchise tax. This tax is equal to $1.50 per $1,000 of the largest of the following:
a) The sum of capital stock, surplus, and undivided profits apportioned to North Carolina.
b) 55% of the appraised value of real estate and tangible personal property in North Carolina plus the assessed value of intangibles.
c) Net book value of real and tangible personal property in North Carolina.

LEGISLATIVE PROPOSAL #13

IRC UPDATE

Revenue Laws Study Committee
Recommendations to the
2001 Session of the General Assembly

LEGISLATIVE PROPOSAL 13:

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 AND TO MAKE A CONFORMING CHANGE REGARDING FOREIGN SALES CORPORATIONS.

SHORT TITLE: IRC Update.

BRIEF OVERVIEW: Updates the reference to the Internal Revenue Code to make recent amendments to the Code applicable to State law to the extent State law tracks the Code and makes conforming changes.

FISCAL IMPACT:

EFFECTIVE DATE: The proposal is effective for taxable years beginning on or after 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

S/H D

2001-LYXZ-018(1.2)
(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: IRC Update. (Public)

Sponsors: Revenue Laws Study Committee.

Referred to:

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1 A BILL TO BE ENTITLED
2 AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED
3 IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS AND TO
4 MAKE A CONFORMING CHANGE REGARDING FOREIGN SALES CORPORATIONS.
5 The General Assembly of North Carolina enacts:
6 Section 1. G.S. 105-228.90(b)(5) reads as rewritten:
7 "(b) Definitions. -- The following definitions apply in this
8 Article:
9 ...
10 (1b) Code. -- The Internal Revenue Code as enacted as of
11 January 1, ~~2000,~~ 2001, including any provisions
12 enacted as of that date which become effective
13 either before or after that date."
14 Section 2. G.S. 105-130.5(a)(13) is repealed.
15 Section 3. Notwithstanding Section 1 of this bill, any
16 amendments to the Internal Revenue Code enacted in 2000 that
17 increase North Carolina taxable income for the 2000 taxable year
18 become effective for taxable years beginning on or after January
19 1, 2001.
20 Section 4. This act is effective for taxable years
21 beginning on or after January 1, 2001.

LEGISLATIVE PROPOSAL 13: IRC Update

BILL ANALYSIS

Committee: Revenue Laws
Date: January 10, 2001
Version: 2001-LYXZ-018(1.2)

Sponsor:
Analysis by: Y. Canaan Huie
Staff Attorney

SUMMARY: Updates the reference to the Internal Revenue Code to make recent amendments to the Code applicable to State law to the extent State law tracks the Code and makes conforming changes.

Update Code Reference

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. Since the General Assembly updated the State's reference to the Internal Revenue Code to January 1, 2000, Congress enacted six bills that affect the Code. Four of these bills may affect State revenues and will be discussed here.

This act rewrites the definition of the Code to change the reference date from January 1, 2000 to January 1, 2001. The act further provides that the federal tax law changes that could increase an individual's or a corporation's State taxable income for the 2000 tax year will not become effective for the 2000 tax year but will instead apply only to taxable years beginning on or after January 1, 2001. This provision is necessary because Article 1, Section 16, of the North Carolina Constitution prohibits the legislature from passing a law that will retroactively increase the tax liability of any taxpayer.

Public Law 106-230. This law amends provisions of the Code dealing with political organizations. Under this law, certain political organizations[1] are required to notify the Internal Revenue Service of their existence, both electronically and in writing, within 24 hours of their establishment. Failure to provide proper notice to the Service will result in exempt function income being treated as taxable income for the period in which the organization has not satisfied the notice requirement. The taxable income of political organizations is taxed at the highest rate specified in § 11(b) of the Code – currently 35%. Since North Carolina taxable income is based on federal taxable income, a failure to file the notice may result in increased tax liability at the State level as well as the federal level.

Public Law 106-554. This law makes the following changes[2]:

[1] Three types of organizations are not required to file the notice. They are: 1) Persons required to report under the Federal Election Campaign Act of 1971 as a political committee; 2) Organizations that reasonably anticipate that their annual gross receipts will always be less than $25,000; and 3) Organizations that are described in § 501(c) of the Code that are subject to §527(f)(1) because they have made a political expenditure.

[2] Parts of the summary of Public Law 106-554 rely heavily on: Joint Committee on Taxation, Summary of Provisions Contained in H.R. 5662, the "Community Renewal Tax Relief Act of 2000" (JCX-112-00), December 15, 2000.

Low-Income Housing Tax Credit. This law increases the per-capita low-income housing credit cap from $1.25 per capita to $1.50 per capita in calendar year 2001 and to $1.75 per capita in 2002. Beginning in 2003, the per-capita portion of the credit cap will be adjusted annually for inflation.

Under G.S. 105-129.16B, North Carolina has a tax credit for low-income housing that is based on the federal credit. A taxpayer that is allowed a low-income housing credit under federal law with respect to a qualified North Carolina building is allowed a credit under Article 3B of Chapter 105[3]. The North Carolina credit is equal to a percentage of the federal credit. North Carolina low-income housing is eligible if it meets one of the following conditions:

1. It is located in a tier one or two enterprise area.
2. It is located in one of twenty-six counties that sustained severe or moderate damage from a hurricane in 1999.
3. 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 median gross income.
4. 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.

If the building meets one of the first two conditions, the taxpayer is allowed a credit equal to 75% of the federal credit. If the building meets one of the latter two conditions, the taxpayer is allowed a credit equal to 25% of the federal credit.

Renewal Communities. This law allows the Secretary of Housing and Urban Development to designate up to 40 renewal communities from areas nominated by State and local governments. Renewal communities are similar to empowerment zones and taxpayers in renewal communities are eligible for a number of tax incentives. The following incentives affect taxable income:

- Capital gains on sales of qualified business assets that are held for more than five years are not included in gross income.
- The taxpayer is allowed a "commercial revitalization deduction" for a qualifying building revitalization. At the election of the taxpayer, the deduction is either 50% of qualifying expenditures for the taxable year that the building is put into service or all of the expenditures ratably over a 40-year period.
- The taxpayer is allowed an additional $35,000 worth of Section 179 expensing for qualified property.

Empowerment Zones. This law extends the designation of existing empowerment zones through December 31, 2009. The law also allows the Secretary of Housing and Urban Development and the Secretary of Agriculture to designate a total of 9 additional empowerment zones. There are

[3] Credits allowed under Article 3B may be applied towards either the franchise tax or the income tax. The taxpayer must choose to which tax the credit will apply when the first installment of the credit is claimed.

currently no empowerment zones located in North Carolina. Taxpayers in empowerment zones are eligible for a number of tax incentives, including the following that affect taxable income:

- The taxpayer is allowed an additional $35,000 of Section 179 expensing for qualified property. Under previous law, the taxpayer was allowed an additional $20,000 of Section 179 expensing.
- Certain businesses in existing enterprise zones become eligible for more generous tax-exempt bond rules.
- The law allows a taxpayer to roll over gain from the sale of a qualified empowerment zone asset held for more than one year if the taxpayer uses the proceeds to purchase other qualifying empowerment zone assets within 60 days.
- The law increases from 50 percent to 60 percent the exclusion of gain from the sale of qualifying small business stock held for more than 5 years if the stock satisfies the requirements of a qualifying business.

Environmental Remediation Costs. Section 198 of the Code allows a taxpayer to expense certain environmental remediation costs. This law affects Section 198 in two ways. First, prior to this law, Section 198 was set to expire for costs incurred or paid after December 31, 2001. This law extends that expiration date to December 31, 2004. Second, this law expands the number of sites that are eligible under Section 198. Previously, for a site to be eligible it had to be located in a "targeted area". Targeted areas were determined by looking at the poverty rate in the area, the population of the area, and the location of the area. This law eliminates the requirement that the site be in a targeted area.

Corporate Donations of Computer Technology. Under previous law, a corporation was allowed an enhanced deduction for a donation of computer technology or equipment to a primary or secondary educational institution so long as the donation was made within two years of acquiring the computer technology or equipment and the donation was made by the manufacturer or the original purchaser. This enhanced deduction was set to expire for donations made during any taxable year beginning after December 31, 2000. This law makes four changes in this area. First, the enhanced deduction is extended for an additional 3 years. Second, the enhanced deduction is expanded to include donations of computer technology and equipment to a public library. Third, the enhanced deduction is expanded to apply to donations made up to three years after the equipment or technology is originally acquired. Fourth, the enhanced deduction is expanded to include property donated after reacquisition by a computer manufacturer.

<u>Public Law 106-573.</u> This law repealed a portion of the Ticket to Work and Work Incentives Improvement Act of 1999, P.L. 106-170. That provision had prohibited the use of the installment method by accrual method taxpayers. Under the law prior to enactment of P.L. 106-170 and after the enactment of P.L. 106-573, the installment method of reporting income from dispositions of property can be used by a taxpayer regardless of whether the taxpayer uses the cash method or accrual method of accounting. 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. 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. P.L. 106-170 prohibited an accrual method taxpayer from using the installment method except under certain limited circumstances. Neither P.L. 106-170 nor P.L. 106-573 affected the right of a cash method taxpayer to use the installment method.

Public Law 106-591[4]. In general, income earned by a foreign corporation from its foreign operations is subject to federal income tax only when the income is distributed to a U.S. taxpayer that holds stock in the corporation. Under prior federal law, income earned by foreign sales corporations was given special tax treatment. This law repealed the federal tax rules for foreign sales corporations and substituted an exclusion from gross income for extraterritorial income. The new federal law became effective for transactions that occur on or after October 1, 2000. The exclusion applies to both corporate and individual taxpayers. Expenses allocated to the excludible income generally are not deductible. The exclusion is a means of avoiding double taxation, so no foreign tax credit is allowed for foreign taxes paid on the excluded income.

When the North Carolina tax law is amended to update the reference to the Internal Revenue Code, North Carolina will piggyback the federal exclusion of extraterritorial income. Dividends a North Carolina taxpayer receives from a foreign corporation will be taxable as under federal law (except to the extent North Carolina law allows a corporate taxpayer to deduct dividends it receives from its subsidiaries).

Under prior law, a U.S. corporation that was a shareholder in a foreign sales corporation was not required to pay federal income tax on income attributed to a foreign sales corporation. The foreign sales corporation paid federal income tax on part of its income. Under a provision of North Carolina law, a corporate taxpayer is required to include in its taxable income the portion of its income that is attributed to a foreign sales corporation to the extent the foreign sales corporation is required to pay federal income tax on the income.[5] Because the new federal law repeals these foreign sales corporation provisions, the related provision of North Carolina law is obsolete and can be repealed.

The repealed federal law allowing for the creation of foreign sales corporations and the attribution of income to them provided a way for the federal government to indirectly subsidize export sales of goods made in the United States. A foreign sales corporation was a corporation created by a parent or other related corporation for the purpose of making export sales of the parent's or other related corporation's goods or services. The parent or other related corporation could attribute income from the sale of exports to the foreign sales corporation and

[4] Background information on the federal law is drawn from: Joint Committee on Taxation, Technical Explanation of the Senate Amendment to H.R. 4986, the "FSC Repeal and Extraterritorial Income Exclusion Act of 2000" (JCX-111-00), November 1, 2000.

[5] Unlike the federal government, the State could not tax the foreign sales corporation because, by definition, a foreign sales corporation is a kind of foreign corporation over which the State has no jurisdiction and therefore no authority to tax as a separate entity.

part of the attributed income was exempt from the federal taxable income of the foreign sales corporation.

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 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.

FISCAL ANALYSIS MEMORANDUM

DATE: January 23, 2001

TO: Revenue Laws Study Committee

FROM: Richard Bostic
Fiscal Research Division

RE: Legislative Proposal #13
IRC Update

FISCAL IMPACT

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

($ million)

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
GENERAL FUND	-3.37	-3.59	-2.63	-2.34	-3.39
EXPENDITURES					

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

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2001.

BILL SUMMARY: Section one of the bill updates the reference to the Internal Revenue Code used in state tax provisions from January 1, 2000 to January 1, 2001. Section two repeals an obsolete statute dealing with foreign sales corporations. Section three clarifies that any changes that increase North Carolina taxable income for the 2000 taxable year become effective for taxable years beginning on or after January 1, 2001.

ASSUMPTIONS AND METHODOLOGY: Since North Carolina individual and corporate income tax law tracks the federal income tax law, it is necessary each year to update state statutory references to the Internal Revenue Code (IRC). Congress enacted four bills in calendar year 2000 that have a potential revenue impact on the state General Fund.

Public Law 106-230

HR 4762 was enacted to require 527 organizations to disclose their political activities. If an organization does not comply with the disclosure provisions of this act, then their exempt function income becomes taxable. This fiscal memo assumes no fiscal impact for North Carolina from this provision.

Public Law 106-554

This 2001 appropriations act (HR 4577) for the Departments of Labor, Health and Human Services, and Education contains numerous tax provisions taken from other introduced legislation.

- Low Income Housing Tax Credit - P.L. 106-554 increases the annual low-income housing credit amount allocated to each state from $1.25 per capita to $1.50 per capita in 2001 and $1.75 per capita in 2002. The per capita allocation will be adjusted by the CPI after 2003. North Carolina has a state low-income housing tax credit that is equal to 1) 75% of the federal low-income housing credit in Tier 1 & 2 counties and in counties damaged by hurricanes in 1999, and 2) 25% in all other counties. The credit is taken over five years.

	Population	Prior Law Per capita	Prior Law Federal Credit	Current Law Per capita	Current Law Federal Credit	Difference
2000	7,323,000	$1.25	$9,153,750	$1.25	$9,153,750	$0
2001	8,049,313	$1.25	$10,061,641	$1.50	$12,073,970	$2,012,328
2002	8,221,568	$1.25	$10,276,960	$1.75	$14,387,745	$4,110,784
2003	8,397,510	$1.25	$10,496,887	$1.79	$14,989,555	$4,492,668
2004	8,577,217	$1.25	$10,721,521	$1.82	$15,647,159	$4,925,638
2005	8,760,769	$1.25	$10,950,961	$1.87	$16,365,576	$5,414,615
2006	8,948,249	$1.25	$11,185,312	$1.92	$17,150,410	$5,965,099

The North Carolina credit is a percentage of the federal tax credit allocation (shown above) times ten, because the credit is granted to a taxpayer each year for ten years. This increased federal allocation will increase the General Fund revenue loss for the state credit each year until the credit sunsets in 2006. This fiscal estimate assumes that NC taxpayers make up 40% of federal credit investors initially but will increase to 60% by 2006.

	2001-02	2002-03	2003-04	2004-05	2005-06
State Tax Credit					
Previous law	$1,373,063	$3,339,996	$5,384,622	$7,866,637	$10,532,977
Current law	$1,373,063	$3,641,845	$6,403,706	$9,933,634	$13,804,324
Additional GF Cost	$0	$301,849	$1,019,083	$2,066,998	$3,271,347

- Renewal Communities - P.L. 106-554 allows the Secretary of Housing and Urban Development (HUD) to designate up to 40 renewal communities that will be eligible for tax incentives. There is currently no fiscal impact from this provision.

If HUD chooses a site in North Carolina, then there would be a General Fund revenue loss.

- Empowerment Zones - This act allows HUD to designate 9 additional empowerment zones across the country. There will be no fiscal impact from this provision unless HUD selects North Carolina for an empowerment zone.

- Environmental Remediation – This act expands the number of sites eligible for expensing of environmental remediation costs and extends the use of this expensing method from 2002 to 2004. Based on data from the Department of Environment and Natural Resources, there are over 1000 potential brownfields sites across the state that are currently underutilized or idle due to real or perceived environmental contamination. Since it is unknown as to how many North Carolina taxpayers will take advantage of this expensing method to cleanup brownfield sites, this fiscal memo uses .542% of the national estimated revenue loss. (This percentage represents North Carolina corporate tax collections as a percentage of the national tax collections.)

- Corporate Donations – This act extends the enhanced corporate tax deduction for the donation of computer equipment until 2003. This provision also expands the deduction to include donations 1) to public libraries, 2) of property reacquired by a computer manufacturer, and 3) of equipment acquired up to three years before the donation is made. Since North Carolina specific data is unavailable, this fiscal memo uses .542% of the national estimated revenue loss. (This percentage represents North Carolina corporate tax collections as a percentage of the national tax collections.)

- Medical Savings Accounts – This act extends the Medical Savings Account program from 2000 to 2002 and renames the accounts as the Archer MSAs. There is no fiscal impact of this bill because North Carolina taxpayers have not utilized these accounts in the four years of the program's existence.

Public Law 106-573

HR 3594, the Installment Tax Correction Act of 2000, reversed a prohibition of accrual method taxpayers using the installment method for reporting income from dispositions of property. It was reported that this prohibition had a direct impact on the sale of S corporations. When the General Assembly approved the IRC update in HB 1559, the fiscal note listed a revenue gain for prohibiting the installment method for accrual method taxpayers. This fiscal note removes the anticipated gain from future year budgets.

Public Law 106-591

With the passage of HR 4986, FSC Repeal and Extraterritorial Income Exclusion Act of 2000, Congress repealed foreign sales corporations (FSCs) due to the protest of the World Trade Organization. To provide corporations with tax benefits that mirror FSC provisions, HR 4986 enacted extraterritorial income exclusion. This act allows companies to exclude foreign trade income from their US taxable income. Both the Department of

Revenue and the Internal Revenue Service feel that this change in tax policy is revenue neutral.

Federal Tax Changes - Impact on NC General Fund

	Effective Date	Fiscal Years ($ Millions) 2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Public Law 106-230							
Political Organizations	7/1/2000	No fiscal impact unless future violation					
Public Law 106-554							
Low income housing credit	12/31/2000	0	-.3	-1.01	-2.07	-3.27	-4.59
Renewal communities	12/15/2000	No estimate available - communities not yet established					
Empowerment zones	12/15/2000	No estimate available - new zones not yet selected					
Environmental remediation	12/15/2000	-0.53	-1.22	-0.89	-0.21	-0.01	0.03
Computer Donation	12/31/2000	-0.64	-0.68	-0.34	-0.02	-	-
Medical Savings Accounts	12/15/2000	No fiscal impact					
Public Law 106-573							
Accrual method	12/28/2000	-2.20	-1.39	-0.39	-0.04	-0.11	-0.19
Public Law 106-591							
Foreign sales corporation	9/30/2000	No fiscal impact					
Total G.F. Impact		**-3.37**	**-3.59**	**-2.63**	**-2.34**	**-3.39**	**-4.75**

TECHNICAL CONSIDERATIONS:

APPENDIX A

AUTHORIZING LEGISLATION

ARTICLE 12L
Revenue Laws Study Committee

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§ 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.)

APPENDIX B

ISSUES REFERRED TO THE 1999-2000 REVENUE LAWS STUDY COMMITTEE

Issues Referred to the 1999-2000 Revenue Laws Study Committee

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.
- Any necessary changes to the Shareholder Protection Act and the Business Corporation Act (SL 99-395, Sec. 13.1)
- The simplification of all State revenue and tax forms (SL 00-138, Sec. 4.1)
- Affordable housing (SL 00-138, Sec. 4.1) Tax credits, including adjustments to and credits for ad valorem taxes, to encourage production of affordable housing
- Investment advisory committee (SL 00-138, Sec. 4.1) The establishment of an investment advisory committee to serve as a liaison between the General Assembly and the Department of the State Treasurer and to assist the Treasurer in setting investment policies for the State.
- Homestead exemption (SL 00-138, Sec. 4.1; HB 1700; SB 1484)
- Simplification of taxes on telecommunications (SL 00-138, Sec. 4.1; SB 1320)
- Interstate tax cooperation to eliminate multiple filings by individuals (SL 00-138, Sec. 4.1; SJR 958)
- Impacts of State Acquisition of Land for Conservation Purposes on Local Governments Property Tax Revenues (SL 00-138; Sec. 4.2)
- Interstate income tax agreements (SL 00-138; Sec. 4.3) Agreements regarding income taxes of individuals who work across NC's borders from their states of residence. The agreements usually provide that an individual residing in one state (residence state) and employed in another state (work state) is taxes as if the earnings in the work state were sourced in the residence state. They also provide for the work state employer to withhold residence state income taxes.

APPENDIX C

FINAL DISPOSITION OF BILLS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE TO THE 2000 REGULAR SESSION OF THE 1999 GENERAL ASSEMBLY

FINAL DISPOSITION OF BILLS
RECOMMENDED BY THE
REVENUE LAWS STUDY COMMITTEE
TO THE 2000 REGULAR SESSION

BILL #	SHORT TITLE	FINAL STATUS	OVERVIEW
HB 1290	Revenue Laws Clarifying Changes	**Enacted** ***SL 00-173***	This act makes numerous clarifying and conforming changes to the revenue laws and related statutes. These changes were originally included in House Bill 1575. *(Additional conforming and technical changes to the revenue laws were made in Senate Bill 1335, enacted as S.L. 2000-140.)*
HB 1544	Refund Overpayment of Deed Stamp	**Enacted** ***SL 00-170***	This act establishes a procedure through which a taxpayer may request a refund of an overpayment of the State excise tax on conveyances.
HB 1545	Excise Tax on Timber Contracts	**Enacted** ***SL 00-16***	This act clarifies that the State excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber. The Revenue Laws Study Committee recommended this legislation to end any confusion resulting from two court decisions regarding the treatment of timber deeds and contracts for the sale of standing timber.
HB 1551	Tax Enforcement	**Enacted** ***SL 00-119***	This act makes the following changes to the law to facilitate enforcement of the tax laws: • It expands the offenses revenue law enforcement officers may enforce to include misdemeanor offenses as well as felony offenses. This part of the act became effective July 14, 2000. • It authorizes the Secretary of Revenue to administer the oath of office to revenue law enforcement officers. This part of the act became effective July 14, 2000. • It creates a civil penalty for filing a frivolous income tax return. A frivolous return is one that meets both of the following conditions: (1) it 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) It evidences an intention to delay, impede, or negate the revenue laws of this State or purports to

Bill #	Short Title	Final Status	Overview
			adopt a position that is lacking in seriousness. The penalty for filing a frivolous return is up to $500. This part of the act becomes effective October 1, 2000, and applies to returns filed on or after that date. • It streamlines the procedures State and local law enforcement agencies must use to report arrests made for the failure to pay tax on unauthorized substances by allowing them to give the information directly to the Department of Revenue. This part of the act becomes effective December 1, 2000, and applies to arrests or seizures occurring on or after that date.
HB 1559	Conformity with Federal Law	**Enacted** ***SL 00-126***	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 June 1, 1999, to January 1, 2000. This change became effective for taxable years beginning on or after January 1, 2000. • **Conform Pension Tax Withholding.** It requires withholding of State income taxes on an eligible rollover distribution to the extent permitted under federal law. This change becomes effective January 1, 2001. • **Conform Estimated Tax Deadline for farmers and fishers.** It returns the withholding law for farmers and fishers to conformity with federal law, correcting an inadvertent change made in 1985. This change became effective July 14, 2000. • **Clarify Sales Factor.** It amends the definition of "sales" for purposes of the apportionment formula to clarify that the receipts of a multi-state corporation should include only the net gain realized from the sale or maturity of securities, not the rolled over capital or return of principal and not receipts otherwise exempt from tax. This change became effective July 14, 2000. • **Participate in Treasury Offset Program.** It enables the Department of Revenue to collect delinquent tax debts owed to the State through the United States Department of the Treasury Offset Program by providing for the imposition of a collection assistance fee. This change became effective July 14, 2000.

BILL #	SHORT TITLE	FINAL STATUS	OVERVIEW
HB 1560 *ID=SB 1319*	Modify Bill Lee Tax Credits	**Enacted** ***SL 00-56***	This act modifies the William S. Lee Quality Jobs and Business Expansion Act and related economic development laws by enacting application fee changes, extending credit carryforwards, requiring wage standards for grants, prohibiting funding for defaulting grantees, expanding credits, and making technical corrections.
HB 1573 *ID=SB 1280*	Health Care Facility/CCRC Tax Exempt	**Enacted** ***SL 00-20***	This act does two things. First, it provides that the current property tax exemption for continuing care retirement centers (CCRCs) will remain in effect for one more year, by extending the exemption's sunset from July 1, 2000, to July 1, 2001. Second, it clarifies the property tax exemption for health care facilities financed with bonds or notes issued by the Medical Care Commission in two ways: • The amount of the exemption cannot exceed the lesser of the principal amount of the bonds or notes or the assessed value of the facility. • Only the part of a health care facility financed by bonds or notes issued by the Medical Care Commission is exempt from property tax. When bonds or notes are used to finance an expansion or a renovation of an existing facility, only the new part of the facility or the renovated part of the facility may be exempt from property tax, not the entire facility.
HB 1575	Revenue Laws Technical Changes	*See HB 1290 – Revenue Laws Clarifying Changes, and SB 1335 – 2000 Technical Corrections*	
HB 1624	Streamlined Sales Tax System	**Enacted** ***SL 00-120***	This seeks to improve the State's 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 allows the Department of Revenue to retain necessary funds from revenues it collects from its nonresident delinquent tax debt contracts

BILL #	SHORT TITLE	FINAL STATUS	OVERVIEW
			to obtain assistance in developing a performance-based contract for an automated collection system. The General Assembly asked the Department and the State Controller to study how to collect taxes more efficiently. The centralization and automation of the Department's delinquent tax debts are the primary recommendations of this study, conducted by PricewaterhouseCoopers. • 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. • It repeals the requirement that a taxpayer report use tax on the income tax return.
HB 1840	2000 Appropriations Act	*Enacted* **SL 00-67**	Section 7.11 of this act allows the Property Tax Commission to receive travel, subsistence, and salary while being trained.
SB 1304	Property Tax Commission Training	*See HB 1840 – 2000 Appropriations Act.*	
SB 1309	Pension Tax Withholding	*See HB 1559 – Conformity with Federal Law.*	
SB 1320	Simplify Tax on Telecommunications	Senate Finance	This bill would have made changes that would have simplified the tax on telecommunications by: • Taxing prepaid telephone calling cards at the point of sale. • Applying one tax at one rate to all telecommunications services, including interstate communications. • Establishing a local sourcing rule for wireless communications. • Eliminating complicated distribution formulas for local revenue sharing while preserving the local revenue stream.
SB 1335	2000 Technical Corrections	Enacted *SL 00-140*	This act makes numerous clarifying and conforming changes to the revenue laws and related statutes. These changes were originally included in House Bill 1575. *(Additional conforming and technical changes to the revenue laws were made in House Bill 1290, enacted as S.L. 2000-173.)*

APPENDIX D

INFORMATION ON THE PERFORMANCE AUDIT OF THE DEPARTMENT OF REVENUE

STATE OF NORTH CAROLINA
Office of the State Auditor

Ralph Campbell, Jr.
State Auditor

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PRESS RELEASE

For Immediate Release: October 27, 2000

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STATE AUDITOR RALPH CAMPBELL RELEASES PERFORMANCE AUDIT ON THE NORTH CAROLINA DEPARTMENT OF REVENUE

The 1999 Session of the General Assembly directed the State Auditor to conduct an audit of the North Carolina Department of Revenue (Department). The major issues the legislation directed the Auditor to examine included the Integrated Tax Administration System (ITAS), other automation projects in the Department, and the Department's overall use of technology to improve services to our citizens. The review also included examining methods used to process tax returns and payments. Because of the specialized nature of the automated systems used by the Department, KPMG LLP was employed by the State Auditor to assist our performance audit and information systems audit staffs in the examination of ITAS and the other automated systems at the Department of Revenue. KPMG's findings and recommendations are included as part of this report.

State Auditor Ralph Campbell stated, "Performance audits are designed to identify improvements that could result in more effective operations. To this end, we believe that the Department has opportunities in several areas to further improve operations through the use of increased automation. One significant recommendation is that the North Carolina Department of Revenue should set a goal of a seven-day turnaround for processing individual income tax refunds for taxpayers who file electronically and choose the direct deposit option. This goal is clearly within the Department's reach if the General Assembly approves funds for the Department to implement a direct deposit option to taxpayers' bank accounts. Our analysis shows that this change alone would save the State approximately $2.2 million per year if just 60% of taxpayers elected to use this option. It would also mean that a significant sum would be returned to individual taxpayers sooner, both to their benefit and to the economy of North Carolina. For the 1999 tax year, over 2.4 million individual tax refunds were distributed totaling over $1.1 billion. Obviously, the more taxpayers using this option, the more the savings to the State and the greater the economic impact overall.

"Perhaps more important than the savings to the State," Auditor Campbell said, "is that this change would allow the Department to get refunds back to taxpayers in a more timely manner. Our examination of the issues surrounding the tax refund problems from the 1999 tax season showed that a number of events caused delays. First, the number of returns that the Department handles has grown dramatically as North Carolina's population has increased. The second major event that occurred this year was the deployment of the Data Capture system that allows the Department to digitally scan tax returns. This allows ITAS to detect more

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errors than had been the case in the past. These errors had to be manually researched and resolved before the refund could be processed. Lastly, because North Carolina has not offered a direct deposit option, a check for each refund had to be produced, processed, and mailed. This step alone adds six to eight days to the time required for the taxpayer to receive a refund."

Auditor Campbell continued, "Our review of the Department's overall operations showed that it is operating as effectively as it can with the current levels of staff and automation. In our opinion, there are still considerable opportunities for the Department to increase tax revenues for the State. However, to increase revenues the Department will need additional resources, both in personnel and in technology. We found that currently Department management is forced to shift permanent employees from their main functions to assist in the processing of the influx of individual tax returns each year. This practice has resulted in significant backlogs of work in a number of areas such as working accounts receivables, Revenue Agent Reports (notices from the IRS of a change on a federal tax return that would likely change the State tax return), and bankruptcy cases. We estimate that given adequate staff to focus on these functions to eliminate the existing backlogs, the Department could increase the State's tax revenues by almost $72 million dollars.

"A major recommendation from the report is the need to establish a centralized taxpayer telephone assistance center with toll-free numbers for use by citizens. Currently, the main telephone line for taxpayer assistance can only handle three calls at the same time, with two additional calls waiting. To create an effective call center using automated and interactive telephone devices, the Department would require adequate funding for automated equipment and programs. This would allow the Department to offer access to both a voice response option, as well as live assistance," State Auditor Campbell said. "The recent reorganization undertaken by the Secretary would facilitate the creation of such a call center."

Auditor Campbell noted, "Another recommendation describes the need to process amended returns in a more timely manner. This is one of the areas where staff is shifted to help with processing of individual tax returns, thus creating a backlog of amended returns. Additionally, the Department needs to develop a specif form for amended sales and use tax returns. The report also identified a number of other areas where improvements can be made in the processing of other types of returns. Based on our review, we believe the Department could justify 74 additional positions to improve effectiveness and efficiency as identified in the report. The estimated total cost (including benefits) of these positions would be $4.4 million."

"The North Carolina Department of Revenue provides a critical service to our citizens and to our State government. The Secretary and her staff have made strides in greatly improving that service and should be recognized for those efforts. North Carolina's Department of Revenue is a leader in many aspects of tax collection and processing. I want to commend Secretary Offerman and her staff for the many innovations they have put in place to better perform the tax administration function for the State," Auditor Campbell noted.

"The Department has, however, a number of unique opportunities to vastly improve its image with our citizens, its services to our citizens, and revenue generation for the State. The General Assembly has an important role to play in the continued improvement of the North Carolina Department of Revenue by prioritizing new technological initiatives and providing the needed funds for increased personnel and automation. The Secretary has reviewed the draft report and is in agreement with many of the recommendations contained therein. In fact, the Secretary and her staff initiated a number of the recommended changes as the audit progressed," Auditor Campbell concluded.

Copies of this performance report, including the response from the Secretary of the Department of Revenue, are available by contacting the Office of the State Auditor at the address above or by electronic mail **(reports@ncauditor.net).** The full report is available on the OSA Internet home page, **http://www.osa.state.nc.us**, under the section, "What's New?" Click on the heading "Audits" to view the report.

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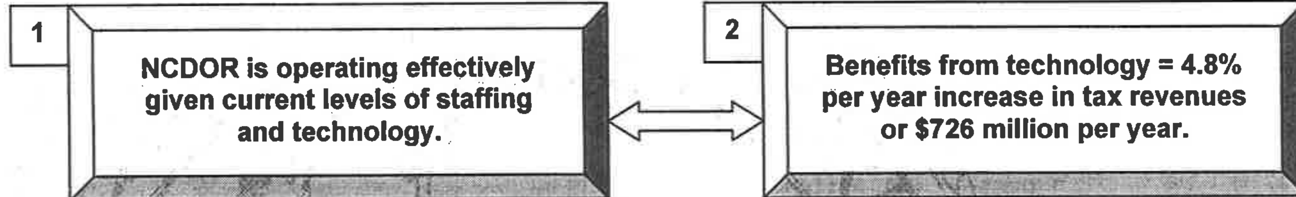
SUMMARY OF MAJOR FINDINGS and RECOMMENDATIONS

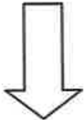
FROM THE PERFORMANCE AUDIT OF

THE NORTH CAROLINA DEPARTMENT OF REVENUE

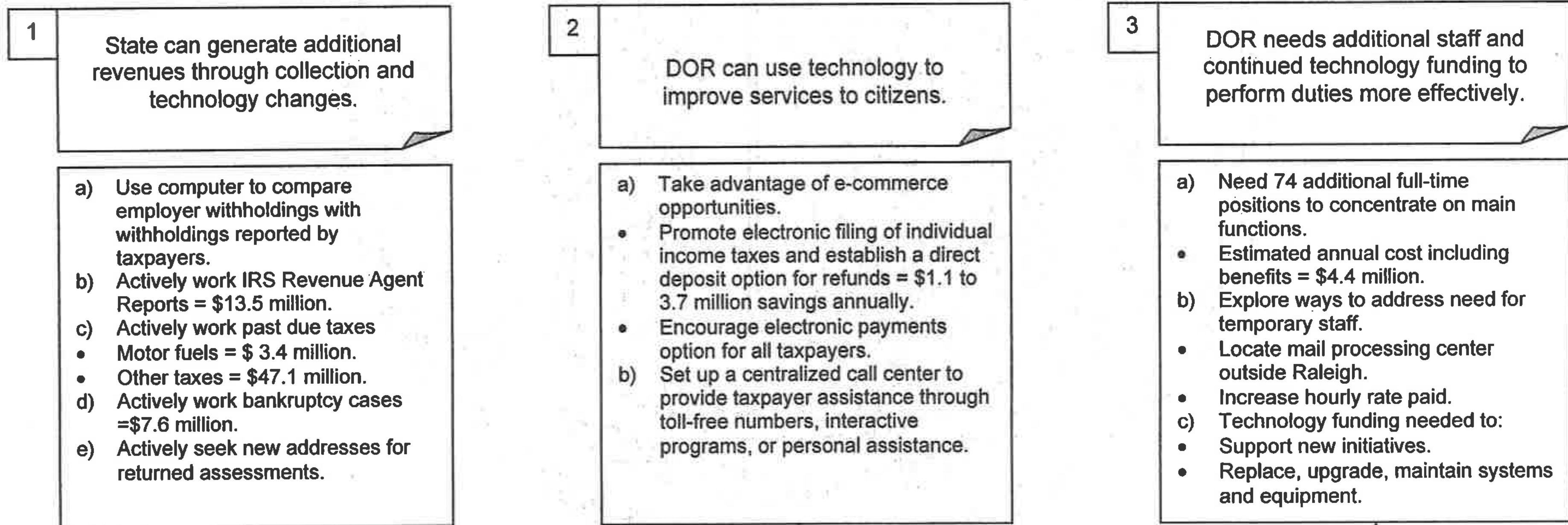
Issued October 2000

MAJOR CONCLUSIONS:





MAJOR RECOMMENDATIONS:



OFFICE OF THE STATE AUDITOR

Ralph Campbell, Jr.
State Auditor

December 14, 2000

PERFORMANCE AUDIT

NORTH CAROLINA DEPARTMENT OF REVENUE

October 2000

EXECUTIVE SUMMARY

Program Description

The North Carolina Department of Revenue (DOR) was created in 1921, with 16 employees, when the General Assembly instituted the State's first net income tax. The Department is authorized by GS §143B-217. In fiscal year 2000-01, as a result of increases in North Carolina's population, industry, and the increased complexity of the modern taxation system, DOR now employs 1,265 full-time staff, as well as numerous temporary employees during the "tax season." DOR has staff located in the central office in Raleigh, 37 field offices throughout the State, and 38 interstate auditors who examine records of North Carolina taxpayers who live in states outside North Carolina. DOR collects property tax, inheritance and gift tax, beverage and cigarette taxes, corporate income and franchise tax, gasoline tax, individual income tax, sales and use tax, and administers privilege licenses. For fiscal year 1999-00, DOR collected $17.6 billion in tax revenue and had an agency budget of approximately $102 million.

Audit Scope and Methodology

This performance audit of the North Carolina Department of Revenue was mandated in the 1999 House Bill 1476, Section 4(b). The scope of the audit included all areas of operation within the department. Special emphasis was placed on DOR's use of technology to assist in the performance of the many functions and duties assigned to the department.

Audit Objectives

As outlined in House Bill 1476, Section 4.b, we had five major audit objectives.

1. Review the tax collection and tax auditing activity, with particular attention to the cost, efficiency, and effectiveness of the Integrated Tax Administration System (ITAS) and subsequent automation projects.
2. Review current methods of processing tax returns and payments and the ability to employ the latest technology in this processing.
3. Review the internal organization and management structure, and current and future staffing requirements.
4. Review budgeting and the fiscal management aspects of DOR.
5. Review any other issues as may be deemed necessary or desirable by the State Auditor.

Conclusions in Brief

North Carolina's Department of Revenue is recognized as a national leader in many of the tax administration functions it performs for the State. Senior management has worked hard in the last few years to create an organizational culture that is willing to internally review its operations for the purpose of continuous improvement. To this end, DOR established total quality management teams about six years ago which involve employees in identifying changes needed to work processes. We observed evidence throughout the audit of the positive effects of this philosophy. Management and staff were already working on, or during the audit took, steps to address a number of the issues identified in the report. A number of areas we have identified, however, will require additional resources, which could result in significant increases in the State's revenues. To effectively address the major concerns discussed below, DOR will need additional funding for increased personnel and technology resources. It is our firm belief that such funding is an investment in the future financial health of the State of North Carolina. Below we summarize our conclusions for each audit objective.

EXECUTIVE SUMMARY

OBJECTIVE 1: TAX COLLECTION AND AUDITING ACTIVITY

Overall, DOR performs the tax assessment and collection functions assigned to it under GS §105 in an effective manner given current resource limitations. However, there are areas where we believe increased resources and operational changes would serve to improve the effectiveness and efficiency of DOR.

Collection Activity

The withholding process within ITAS is ineffective, requiring increased manual intervention. As a result, the State may not be collecting tax revenue as timely as possible. Limited resources restrict DOR's ability to focus efforts on certain areas that could increase the State's revenue collections. Based on our analysis, revenues in the following areas could be increased as much as $24.5 million, as follows: IRS Revenue Agent Reports[1]–$13.5 million, collection of Motor Fuels accounts receivable--$3.4 million, and bankruptcy cases--$7.6 million. Additionally, the taxpayer assistance function could be more responsive if additional technological methods were employed.

Information Security and Business Continuity Planning

Security practices and programs are not fully developed, diminishing DOR's ability to provide a secure technology infrastructure for its non-mainframe platforms. Recovery of supporting processes and technology for key elements of tax data processing are at risk in the event of a long-term recovery requirement. DOR's disaster recovery planning efforts to date have been limited to processing by the ITAS application and do not cover critical processes and subsystems in place to capture and process taxpayer data.

Costs of ITAS and Other Automation Projects

Since fiscal year 1987-88, DOR has spent approximately $60 million to improve its technology. The largest portion of these funds, $46.6 million, was used to purchase, modify, and implement ITAS and Data Capture. Approximately 19%, $15.8 million, of DOR's total operati[illegible]dget is spent for information technology costs. For fiscal year 1999-00, the ITAS portion [illegible]e IT budget was $8.25 million. DOR has a separate line item for the Data Capture Project that includes purchase of equipment and operational costs. While we were unable to isolate the benefits the State has derived from ITAS, we were able to determine that after adjustment for the increase in the number of returns filed, gross collections have increased by 4.8% or $726 million per year since 1995. Much of this increase can be attributed to automation. To continue to derive benefits from technology, the State will need to maintain a high level of technology funding for DOR to implement and support initiatives using newer technology, while at the same time maintaining and improving existing technology.

Efficiency and Effectiveness of ITAS and Other Automation Projects

ITAS provides adequate functionality but lacks some functional requirements desired by departmental users. The ITAS planning team has taken steps towards addressing ITAS functionality deficiencies. The size and complexity of ITAS require additional supporting processes and resources to increase the effectiveness of employees using the system. While DOR has made strides in improving its change management function for automated systems, most of its efforts have been directed to ITAS and its mainframe applications.

Auditing Activity

The process of identifying prioritizing and tracking audit efforts using ITAS functionality has not been fully developed. Use of this functionality could result in significant increases to the State's revenues as the most promising candidates for audit are identified.

[1] Revenue agent reports are notices from the IRS of a change on a federal tax return that would likely change the state tax return.

EXECUTIVE SUMMARY

OBJECTIVE 2: TECHNOLOGY AND PROCESSING METHODS

North Carolina is a national leader in the use of imaging to capture paper tax returns. The Data Capture project was well planned and included a cross section of system users, strong executive involvement, and effective vendor management. We noted concern regarding implementation timing and the processes for handling future changes to the system. DOR is working on these concerns.

Best Practices

DOR has made strides in the use of enabling technology for its various tax functions and compares well with other states in use of electronic filing for individual income taxes. However, DOR has additional opportunities to improve support of its business mission and expand its use of E-commerce methods. North Carolina's DOR should continue to actively promote electronic filing and adopt a goal of seven days turnaround for individual income tax refunds.

Operational Issues

From an operational standpoint, DOR needs to concentrate efforts on taxpayer assistance, establish a taxpayer assistance call center and toll free telephone numbers, and develop system and processing measures to more closely monitor operations. Our analysis shows that utilizing a private collection firm to pursue past due accounts could result in as much as $47.1 million in increased tax revenues based on the experience of other states.

Tax Refund Issues

DOR records show that the total number of returns processed has continued to increase. On average, approximately 27% of the total returns filed result in a refund to the taxpayer. Total refunds averaged $1.46 billion per year for fiscal years 1994-95 through 1999-00. Individual taxpayer refunds account for 66% of that amount. For fiscal year 1999-00, DOR experienced a number of processing problems that resulted in late refunds to approximately 6% of taxpayers. However, DOR had to pay **less interest** for late refunds to **individual taxpayers** this year than it did for the past two fiscal years. In examining the events surrounding this "tax season," we found that a number of the causes of late refunds, such as taxpayer errors, were outside DOR's control. Others resulted from lack of adequate staff, both full-time and temporary, to handle the volume of on-going work and process individual tax returns in a timely manner. One procedural change that could get refunds to taxpayers sooner, and result in potential savings to the State, is implementation of a direct deposit option for taxpayers. Based on our estimates, savings could range from $3.7 million if 100% of refunds were direct deposited to $1.1 million if only 30% of refunds were direct deposited.

OBJECTIVE 3: ORGANIZATION, STAFFING AND MANAGEMENT

Lack of sufficient staff and lack of training for staff inhibits DOR productivity. We documented various problem areas throughout the report that can be directly traced to lack of staff or lack of training. We noted concerns regarding the recruiting, hiring, and retention of information technology staff. DOR is competing for technical staff in an area of the State where private industry salary ranges are significantly higher than those DOR can offer. Additionally, due to workloads, training needs of DOR staff are not being met. Lastly, we note that there is a potential to increase tax revenues to the State by increasing the number of interstate audit positions. These auditors average increasing the State's tax assessments by $2.2 million each.

Overall, we have identified 74 positions throughout the department, at an approximate cost of $4.4 million including benefits, that we believe are needed to adequately staff the functions and duties discussed in this report. (We should note that DOR management has identified additional positions that it feels are needed which we did not address in the report.)

OBJECTIVE 4: BUDGETING AND FISCAL MANAGEMENT

DOR's accounts receivable balance has increased 28% during the last three fiscal ye
Management has not had sufficient staff resources to be able to actively work the receiva
and is in the process of contracting with a private collection firm to address this probl
DOR's cash management plan has not been updated since 1987. Additionally, areas wi
DOR are not in compliance with the State's Daily Deposit Act, resulting in lost interest to
State. Lastly, we noted that the Motor Fuels division is not properly computing interes
Motor Fuels taxes and refunds due.

OBJECTIVE 5: OTHER ISSUES

DOR should request a review of the interstate audit positions by the Office of State Person
specifically to address issues surrounding "locality pay."

APPENDIX E

DRAFT LEGISLATION PROPOSED BY THE TAX POLICY COMMISSION:

AN ACT TO APPROPRIATE FUNDS TO THE DEPARTMENT OF REVENUE FOR NEW POSITIONS RECOMMENDED BY THE STATE AUDITOR'S PERFORMANCE AUDIT

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2001

D

BILL DRAFT 2001-LCz-18 [v.1] (01/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/15/2001 11:54:29 AM

Short Title: Fund DOR Audit Recommendations. (Public)

Sponsors:

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO APPROPRIATE FUNDS TO THE DEPARTMENT OF REVENUE FOR
3 NEW POSITIONS RECOMMENDED BY THE STATE AUDITOR'
4 PERFORMANCE AUDIT.
5 The General Assembly of North Carolina enacts:
6 **SECTION 1.** There is appropriated from the General Fund to the
7 Department of Revenue the sum of four million four hundred twenty-eight thousand
8 fifty-seven dollars ($4,428,057) for the 2001-2002 fiscal year and the sum of four
9 million four hundred twenty-eight thousand fifty-seven dollars ($4,428,057) for the
10 2002-2003 fiscal year for salary, benefits, and related expenses for seventy-four new
11 positions recommended by the Office of the State Auditor in its performance audit
12 of the Department of Revenue, as follows:

	Positions	Function	Amount
13	**Positions**	**Function**	**Amount**
14	8 Rev. Tax Auditor I	RAR Processing	$515,761
15	5 Rev. Admin. Off. I	Correspondence	337,523
16	9 Rev. Tax Tech.	Taxpayer Assist.	407,336
17	3 Rev. Admin. Off. I	Taxpayer Assist.	202,514
18	2 Rev. Admin. Off. II	Taxpayer Assist	147,945
19	3 Computer Spec. III	Training	169,455
20	1 Computer Consult. II	Training	61,657
21	2 Computer Consult. I	Help Desk	112,970
22	3 Rev. Admin. Off. II	PD&T/PSIC	221,917
23	12 Rev. Tax. Auditor I	Amended Returns	773,641
24	7 Rev. Tax Tech.	Amended Returns	316,817
25	1 Rev. Field Auditor II	Interstate Auditing	73,972
26	1 Rev. Field Auditor III	Interstate Auditing	81,144
27	9 Rev. Field Auditor I	Field Examination	607,541
28	3 Rev. Field Auditor II	Field Examination	221,917

1 5 Processing Asst. IV Post Data Capture 175,947
2 **SECTION 2.** This act becomes effective July 1, 2001.

APPENDIX F

BILL LEE ACT SAFEGUARDS, FORFEITURES, AND REPORTS

Bill Lee Act Safeguards, Forfeitures, and Reporting Requirements

Certification

1. Application. – To claim the Bill Lee Act credits, the taxpayer must provide with the tax return the certification of the Secretary of Commerce that the taxpayer meets all of the eligibility requirements of G.S. 105-129.4 (type of business; wage standard; large investment; health insurance; environmental impact; safety and health programs) or G.S. 105-129.13 (contributions to development zone agencies). The taxpayer must apply to Commerce for certification of eligibility. The application must contain any information necessary for Commerce to determine whether the taxpayer meets the eligibility requirements. In addition, the application must state the number of full-time jobs to be created that are located within a development zone, the number of full-time jobs to be created that are expected to be filled by employees residing within the development zone, and the number of full-time jobs to be created that are expected to be filled by employees residing within a census tract or census block group that has more than twenty percent (20%) of its population below the poverty level according to the most recent federal decennial census.

   If Commerce determines that the taxpayer meets all of the eligibility requirements with respect to a credit, it issues a certificate describing the location with respect to which the credit is claimed, outlining the eligibility requirements for the credit, and stating that the taxpayer meets the eligibility requirements. If Commerce determines that the taxpayer does not meet all of the eligibility requirements with respect to a credit, it advises the taxpayer in writing of the eligibility requirements the taxpayer fails to meet.

   The taxpayer must pay an fee of $500 per credit (except for tiers one and two), with a maximum of $1,500 a year. One-fourth of the fees go to Commerce and the remaining ¾ go to Revenue for the costs of administering and auditing the credits.
2. Machinery and equipment. The taxpayer must include with the application for certification specific documentation supporting the taxpayer's calculation of the eligible investment.
3. Technology commercialization credit. Commerce must certify that the applicant will make a minimum amount of investment in tier one, two, or three over a five-year period in order for the applicant to qualify. In addition, if the applicant claims the credit for an investment that is offset by other machinery and equipment it takes out of service, Commerce must obtain an AG opinion that the taxpayer meets all of the conditions for a credit under those circumstances.

4. Large investments. – A taxpayer is eligible for large investment enhancements[1] if Commerce certifies that the taxpayer will place in service within a two-year period at least $150 million worth of real property, machinery and equipment, or central office or aircraft facility property.
5. Ten-year carryforward. A taxpayer is eligible for a ten-year carryforward (usual period is five years) if Commerce certifies that the taxpayer will place in service within a two-year period at least $50 million worth of real property, machinery and equipment, or central office or aircraft facility property.
6. Development zone agency. In order for a contribution to a development zone agency to be eligible for a credit, Commerce must certify that the agency will undertake an improvement project in a development zone. Before making this certification, Commerce must require the agency to provide sufficient documentation to establish the identity of the agency, the nature of the project, and that the project is for a community development purpose and is located in a development zone. Commerce may not certify a development zone agency if the agency, any of the agency's officers or directors, or any partner of the agency has ever used any part of a contribution made under this section for any purpose other than an improvement project.

Forfeiture.

1. Generally. A taxpayer forfeits a Bill Lee Act credit if the taxpayer was not eligible for the credit at the time the taxpayer applied for the credit. A taxpayer that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest. If a taxpayer forfeits the credit for creating jobs, the technology commercialization credit, or the credit for investing in machinery and equipment, the taxpayer also forfeits any credit for worker training claimed for the jobs for which the credit for creating jobs was claimed or the jobs at the location with respect to which the technology commercialization credit or the credit for investing in machinery and equipment was claimed.
2. Large investments. – A taxpayer forfeits large investment enhancements if it fails to make the level of investment certified by Commerce within the required two-year period.
3. Ten-year carryforward. A taxpayer forfeits ten-year carryforward if it fails to make the level of investment certified by Commerce within the required two-year period.
4. Technology commercialization credit. A taxpayer forfeits the technology commercialization credit if the taxpayer fails to make the level of investment

[1] For most Bill Lee Act credits, any unused portion of a credit may be carried forward for 5 years; with a large investment, the carryforward is 20 years. For most investments, the machinery and equipment tax credit is allowed only if the taxpayer capitalizes the equipment and does not lease it to another; for large investments, the credit is allowed for equipment the taxpayer does not capitalize and leases from another.

certified by Commerce within the required period or if the taxpayer fails to meet the terms of its licensing agreement with a research university.

5. Development zone agency. The taxpayer forfeits the credit to the extent the development zone agency uses the taxpayer's contribution for any purpose other than an improvement project. Each development zone agency must file with Commerce annual, audited financial statements. If Commerce determines that a development zone agency has used part or all of a contribution for any purpose other than an improvement project, it must notify Revenue of the forfeiture, the taxpayer who made the contribution, and the amount forfeited.
6. Environmental compliance. DENR may audit to verify taxpayers' certifications that they have no pending or final actions against them for significant violations of environmental programs, and must notify Revenue of any false certifications.
7. Safety and health programs. The Department of Labor may audit to verify taxpayers' certifications that they have no pending or final actions against them for recent, serious OSHA violations, and must notify Revenue of any false certifications.

Reports

1. Commerce – Annual. Commerce is required to report to Revenue and FRD by May 1 of each year the number of applications for each credit, the number and enterprise tier area of new jobs with respect to which credits were applied for, the cost of machinery and equipment with respect to which credits were applied for, and the number of new jobs created within development zones, including the percentage of those jobs that were filled by residents of the zones.
2. Commerce – Periodic. Commerce is required to report to the General Assembly by April 1, 2001 on its equity study and its impact study. The equity study concerns whether the formula for establishing enterprise tiers is equitable, especially for smaller counties, and whether expanding NC businesses receive fewer benefits than out-of-State businesses that relocate to NC. The impact study concerns the distribution of the credits and the pattern of development by county, by industry, by new versus expanding business, by size of investment, and by number of jobs. The impact study must also measure the direct costs and benefits of the credits and the trends in use of incentives in other states.
3. Commerce – Interstate Agreements. S.L. 1999-360 requires 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, and to report to Revenue Laws on these efforts by March 1, 2000, and March 1, 2001.
4. Revenue. There are no reporting requirements for Revenue under the Bill Lee Act. Revenue is required to report annually in May on the general business credit, the low-income housing credit, and the renewable energy property credit, and plans to report on the Bill Lee Act credits at the same time.

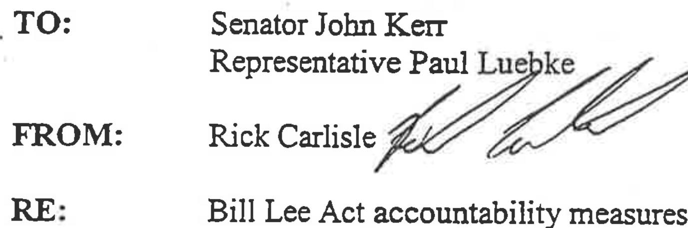
North Carolina Department of Commerce

James B. Hunt Jr., Governor **Rick Carlisle, Secretary**

December 1, 2000

MEMORANDUM

TO: Senator John Kerr
Representative Paul Luebke



FROM: Rick Carlisle

RE: Bill Lee Act accountability measures

I understand from Kathy Sawyer that there were questions raised at the last meeting of the Revenue Laws Committee about accountability measures undertaken by the Department of Commerce under the William S. Lee Act. Kathy tells me that she responded to some of the Committee's questions and concerns. However, I would like to share some additional information with you on the subject.

From the beginning, we built accountability measures into the structure of the Lee Act. Since the incentives are reductions in income tax liabilities, there is no benefit if the company is not in production and operating profitably in the state. Credits for jobs and investment are spread over four to seven years, with credits terminating if the jobs or investment are not sustained. There are penalties for falsely supplying information. And since the incentives are claimed as part of the tax code there are clear legal remedies if the taxpayer does not comply with all requirements.

The Department of Commerce is charged with responsibility for determining initial eligibility for the tax credits. We do this by requiring that the applicant submit an application certifying that they meet the requirements of the Act. This application becomes a part of the tax record and, again, penalties can be applied for falsely supplying information.

From the beginning, we understood that compliance with the provisions of the tax code, once eligibility was determined, was in the province of the Department of Revenue. Revenue's standard procedures in insuring taxpayer compliance and accuracy of returns would be applied to returns claiming credits under the Lee Act. This would not generate any increase in taxpayer returns for existing companies, but the inclusion of new tax credits could generate additional

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workload. Therefore, from the beginning we proposed application fees for applicants for William S. Lee Act credits. Three-quarters of the receipts are allocated to the Department of Revenue to help offset costs. The fee has been increased over time to compensate for an increase in Revenue's auditing functions. Over a one year period, between August of 1999 and September of 2000, we have collected $519,575, and $400,000 of that amount has been transferred to the Department of Revenue.

The $119,575 that has remained within the Department of Commerce has been used to maintain and update our database of claimants for Lee credits. Additionally, we use a portion of these proceeds to contract with the University of North Carolina at Chapel Hill to monitor the use of the Lee Act credits and report to Commerce and the General Assembly. The initial report was released in 1999, and a second report will be released in 2001. The report includes information on geographic distribution of firms taking the credits, the size and industrial classification of firms taking the credits and the fiscal impact of the credits including carryforwards.

We also use the application forms to collect additional information to monitor the use and impact of the tax credits. In response to statutory changes with regards to eligibility and reporting requirements, some of which were at the behest of the General Assembly and some that were added due to Commerce's own desire to expand our accountability measures, the Department has added several questions to the application for certification of eligibility. Questions that have been added since 1998 include the following:

- Additional State Development Zone monitoring
  - Number of full time jobs have been created within the State Development Zone by the taxpayer
  - Number of jobs to be filled by residents of the Zone
  - Number of jobs to be filled by employees residing within a census track or census block group with more than 20% of its population below poverty level

- In an effort to create a mechanism to allow the Department of Commerce to compare the credits for which an individual taxpayer is eligible to the actual amount of credits taken, the Department added a section on the application for certification requesting this specific information for each tax year since 1996. Due to taxpayer confidentiality, Commerce could not gain access to this information prior to this addition to the application.

Currently, the Department is in the process of preparing a revised application for the 2000 tax year, which will include several additional questions to assist us in determining eligibility. These additions will include:

- Certification by the taxpayer that the company provides health insurance, and pays at least 50% of the premiums, for all full-time employees
- Certification that the company has not had any serious OSHA violations in the previous three years
- Certification that the company has not had any significant environmental violations with the Department of Environment and Natural Resources in the previous five years

This department has found the Lee Act to be a critical tool in the state's economic development efforts. Without the Lee Act, we simply could not compete effectively for new jobs and

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investment in the current environment. Without the Lee Act, we would certainly see less investment in our state's rural areas.

We are committed to administering this tool effectively and accountably. Hence, the Department has recommended and instituted numerous accountability mechanisms to enable the Secretary, the Governor, and the General Assembly to be confident that the Act is having the impact intended, and that taxpayers are complying with the requirements of the Act. We also are firmly committed to transparency and full disclosure of all information necessary for anyone to evaluate the William S. Lee Act. Therefore, we put significant effort into compiling and reporting all information in our possession that bears on the fiscal and economic impact of the Act, except that information that cannot be released under the taxpayer confidentiality statutes.

Thank you for your attention, and I would be glad to provide any additional information.

Cc: Cindy Averette
Stewart Dickinson
✓Martha Harris
Kathy Sawyer

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North Carolina Department of Revenue

James B. Hunt, Jr.
Governor

November 14, 2000

Muriel K. Offerman
Secretary

MEMORANDUM

TO: Revenue Laws Study Committee

FROM: Sabra J. Faires, Assistant Secretary for Tax Administration SJF

SUBJECT: Article 3A Tax Credits

This information is being provided in response to questions raised by the Revenue Laws Study Committee at its October meeting. The questions concern the auditing of Article 3A tax credits (Lee credits) by the Department of Revenue. The Department will provide updated and more complete information to the General Assembly in the spring.

Position and Forms

The Department established a new position with revenue from the application fees for the Lee credits. An employee was hired in the position effective July 1, 2000. This employee is currently being trained about the requirements for claiming a tax credit and has begun working with field examination personnel on auditing returns. The position is dedicated full time to auditing credits, and will work with the Tax Research Division to develop tracking procedures for taxpayers claiming Lee credits. In addition, the Department redesigned the tax credit forms starting with the 1999 income year to expand the information included with the tax return. Copies of the tax credit forms are being provided.

Audit Activity

In the short period of time since the new position was established, it has become clear that auditing returns claiming Lee credits is a complicated, time-consuming job. To date the Department's auditing in this area has coincided with general audits. In the course of auditing, 17 taxpayers claiming Lee credits were identified. The results of closed audits are as follows: credits claimed total $8.6 million; available future installments total $2.4 million; and audit adjustments eliminated $265,796 in credits claimed.

There are currently 29 open audit cases involving Lee credits. For this group of taxpayers, $10.9 million in credits were claimed or have been requested and $100.2 million is available for future installments. Part of these tax credits are claimed on amended returns that are being reviewed prior to issuing refunds.

Forfeiture

On the question of forfeiture of Lee credits, there have been none to date. Forfeiture would occur when a credit was claimed in the past for which the taxpayer is not eligible. The possibility of forfeiture exists with the returns currently being audited. For clarification purposes it should be noted that Lee credits can also expire if the taxpayer does not maintain the required eligibility standards. Expired installments are now reported for tax years 1999 and forward, so the Department will be able to track this information.

cc: Muriel K. Offerman
Secretary of Revenue

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