REVENUE LAWS STUDY COMMITTEE

REPORT TO THE 2007
GENERAL ASSEMBLY OF NORTH CAROLINA
2007 SESSION

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Revenue Laws Study Committee
State Legislative Building
Raleigh, North Carolina 27603

Senator John H. Kerr, III, Cochair ***Representative Paul Luebke, Cochair***

January 29, 2007

TO THE MEMBERS OF THE 2007 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

2005-2006

REVENUE LAWS STUDY COMMITTEE

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PREFACE

The Revenue Laws Study Committee is established in Article 12L of Chapter 120 of the General Statutes to serve as a permanent legislative commission to review issues relating to taxation and finance. The Committee consists of sixteen members, eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. Committee members may be legislators or citizens. The co-chairs for 2005-2006 are Senator John Kerr and Representative Paul Luebke.

G.S. 120-70.106 gives the Revenue Laws 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.

In 2002, the General Assembly established a permanent subcommittee under the Revenue Laws Study Committee to study and examine the property tax system.[1] The subcommittee consists of eight members, four appointed by the Senate chair of the Revenue Laws Study Committee and four appointed by the House chair of the Committee. The subcommittee may recommend changes in the property tax system to the full Committee for its consideration in its final report to the General Assembly. The Property Tax Subcommittee did not meet during the 2005-2006 interim.

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[1] S.L. 2002-184, s. 8.

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 six times after the adjournment of the 2006 Regular Session of the 2005 General Assembly on July 28, 2006. Appendix B contains a copy of the Committee's agenda for each meeting. All of the materials distributed at the meetings may be viewed on the Committee's website: http://www.ncleg.net/committees/. The Committee received numerous requests from legislators, taxpayers, the Department of Revenue, and interest groups to study various issues of tax policy and tax administration. The Committee considered many issues but was unable to take up all of the issues suggested to it. The Committee 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.

REVIEW OF THE RECOMMENDATIONS MADE TO THE 2006 GENERAL ASSEMBLY

The 2006 General Assembly enacted 13 of the Revenue Laws Study Committee's 14 legislative proposals in whole or in part. Appendix C lists the Committee's recommendations and the action taken on them in 2006. A document entitled "**2006 Finance Law Changes**" summarizes all of the tax legislation enacted in 2006. It is available in the Legislative Library located in the Legislative Office Building. It may also be viewed on the Legislative Library's website: http://www.ncleg.net/LegLibrary under 'Studies and Reports,' 'Tax Law Changes (1996 – 2006)'.

COMBINED REPORTING AND 'FORCED COMBINATIONS'

S.L. 2006-196 directed the Revenue Laws Study Committee to review the authority of the Secretary of Revenue to require taxpayers to file consolidated returns and to consider whether the State should require corporations to file consolidated returns. The Committee began its study of these issues by reviewing how corporate income tax is computed in North Carolina for multistate corporations.

Generally, a corporation begins its computation of State net income with its federal taxable income. At the federal level, multistate corporations may file a consolidated federal return. However, under North Carolina law, a corporation may not file a consolidated return unless specifically required to do so by the Secretary of Revenue. North Carolina requires corporations to file as a separate entity, meaning it must determine its State net income as if a separate return had been filed for federal income tax purposes.

Separate entity filing gives corporations with subsidiaries in multiple states the ability to devise ways to shift income from a high effective tax rate state to a low effective tax rate state, often through the use of passive investment companies and inter-company transactions. Over the past several years, the General Assembly has enacted changes to the State's corporate income tax laws to address the shifting of income between states by multistate corporations. In 2001, the State enacted the royalty income reporting option. That legislation provided that income from using a trademark in this State is taxable to this State, regardless of where the corporation that holds the trademark is located. In 2002, the State adopted a broad definition of 'business income.' In 2006, the General Assembly expanded the 2001 legislation to include payments received for the use of patents and copyrights. Despite the efforts, the problem of income shifting between multistate corporations continues to be an issue.

The Department of Revenue has been aggressive in using the tools available to it to require a corporation to file a consolidated return when it believes the corporation's net income attributable to this State is not accurately reflected on its separate entity filing return. This action by the Department is referred to as 'forced combinations'. S.L. 2006-192 directed the Committee to study the issue of forced combinations because taxpayers and the Department have very different opinions as to the Department's statutory authority. The Department has used forced combinations for a number of years and it has collected more than $200 million in taxes from forced combinations. Taxpayers, seeking clarity on the law, have filed lawsuits contesting the Department's authority to force combinations. The Committee listened to both the Department and taxpayers on this issue.

The Committee realizes that issues in the area of forced combinations exist. The Committee believes that a more comprehensive way to address the issue of income shifting between affiliated corporations is through the use of combined reporting. The Governor's Commission to Modernize State Finances recommended this change in 2001. The Multistate Tax Commission adopted a model uniform statute for combined reporting in 2006. Seventeen states currently require combined reporting.[1]

Combined reporting is a method of calculating the income of a group of related corporations for tax purposes. It looks beyond the legal structure of separate incorporations to determine whether two or more related corporations are engaged in a single unitary business. The Committee believes that changing the State's corporate filing structure from single entity reporting to combined reporting will not only broaden the corporate income tax base but also reduce the uncertainty about when corporations need to file combined returns. The Committee directed its fiscal staff to work with the Research Division of the Department of Revenue to determine what the fiscal impact of moving to combined reporting would be. The Committee did not have

[1] Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kentucky, Maine, Minnesota, Montana, Nebraska, New Hampshire, North Dakota, Oregon, Utah, and Vermont. Vermont adopted its law in 2004, effective for taxable years beginning on or after January 1, 2006.

the benefit of a fiscal analysis at the time of this report because the analysis is not expected to be completed until at least March of 2007.

Legislative Proposal 1, *Modernize Corporate Income Tax Filing*, contains the Committee's recommendation that the 2007 General Assembly consider moving from single entity reporting to combined reporting. Without the benefits of a fiscal analysis, the Committee did not make a recommendation as to a change in the corporate income tax rate. However, the Committee anticipates that broadening the corporate tax base, as this proposal recommends, would generate additional corporate income tax revenue and that the corporate income tax rate could be reduced to a rate that would render the proposal revenue-neutral.

Legislative Proposal 1 sets forth the basic structure for combined reporting:

- It requires a corporation that is part of an affiliated group engaged in a unitary business to file a combined report.
- It defines the terms 'affiliated group' and 'unitary business'. The proposal defines an affiliated group as a group of two more corporations in which more than 50% of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member corporations. The term 'unitary business' is defined as one or more related business organizations engaged in business activity both within and without the State among which one or more of the following exist: (1) a unity of ownership, operation, or use; or (2) an interdependence in their functions.
- It requires that all corporations that are part of an affiliated group engaged in a unitary business be part of the combined report – that would include a group member that is a non-US corporation. However, the proposal gives the

combined group the option to exclude a group member whose business activity outside the United States is 80% or more of its total business activity. This election is commonly referred to as a 'water's edge election'.

- It provides that the numerator of the apportionment formula would include only the property, payroll, and sales of those members that have nexus with the State. The Committee found this method of apportionment to be the most accepted method of apportionment, but also the method that continued to leave room for tax avoidance strategies. To minimize the extent to which a corporation could utilize tax avoidance strategies to shift sales from one state to another, the Committee's recommendation includes the adoption of a 'throwback' provision. A throwback provision causes sales to be sourced to the state from which the property was shipped if the destination state does not impose a corporate income tax.

The Committee acknowledges that its proposal will need to be developed further during the legislative session. The proposal does not address several issues that would need to be addressed before the General Assembly enacted legislation requiring combined reporting. Some of those outstanding issues include the following:

- The relationship between combined reporting and the franchise tax statutes.
- Transitional issues.
- Administrative issues.
- A determination as to what corporations, if any, would be excluded from combined reporting.
- How the income of corporations with special apportionment formulas under the current law would be apportioned under combined reporting.

REVIEW OF DISPUTED TAX MATTERS

S.L. 2006-196 directed the Revenue Laws Study Committee to study the administrative process for the review of disputed tax matters. The review of disputed tax matters includes two distinct but overlapping issues: the overall process for challenging an assessment or the denial of a refund and the process for addressing taxes 'paid under protest'.

Tax Appeals

The current tax appeals system is divided among assessments, refund claims for overpayments, and refund claims for the payment of an unconstitutional tax. Each type of claim involves a different procedure.

Upon receipt of a proposed notice of assessment, a taxpayer may request a hearing before the Secretary of Revenue. Prior to scheduling a hearing, the Department will seek to resolve the matter informally through phone conversations, letters, and conferences. If those negotiations are unsuccessful, the case proceeds to a hearing at the Department. In practice, the Secretary does not hold the hearing. Instead, the Secretary exercises the authority given in G.S. 105-260.1 and delegates the responsibility of conducting the hearing and making a decision to an Assistant Secretary of the Department, who serves as the Department's hearings officer. As an Assistant Secretary of the Department, this hearings officer is located within and employed by the Department. At the hearing, a taxpayer may be represented by an attorney, an accountant, or any person who has power of attorney for the taxpayer. The rules of evidence do not apply. The hearings officer does not have authority to decide constitutional issues. The hearings officer must issue a written decision within 90 days of the hearing. This decision is considered the Secretary's decision.

A taxpayer who is dissatisfied with the Secretary's decision may obtain an administrative review of the decision at the Tax Review Board, which is a three-member board consisting of the State Treasurer, the Chair of the North Carolina Utilities Commission, and an appointee of the Governor. The Board holds a hearing, but bases its review on the record established at the Department. The Board must issue a decision within 90 days after the hearing, and the decision may be appealed to superior court. Following this route, the superior court reviews the Tax Review Board's decision based on the record created at the Department. A taxpayer does not have to pay the proposed assessment while the case is under review.

In lieu of seeking review by the Tax Review Board, a taxpayer may pay the tax and bring an action in superior court within 30 days after notification of the Secretary's hearing decision. Following this route, the action in superior court is *de novo*.[2]

Decisions of superior court may be appealed to the North Carolina Court of Appeals and then to the North Carolina Supreme Court. The procedures for appeal from the superior court are the same, regardless of whether the action in superior court is based on the record established at the Department or is a *de novo* action.

The procedure for obtaining a refund of tax paid by a taxpayer depends on the nature of the claim. In either case, the taxpayer must file a written demand with the Department. For overpayment claims, the appeals route is similar to the route for assessments. That is, the taxpayer may seek administrative review through the hearings process with appeal to the Tax Review Board and then to the superior court on the record. The taxpayer may also follow the route for seeking a refund based on the alleged unconstitutionality of a tax statute, which is to file a written demand for a refund, wait 90 days after filing the written demand, and then bring a *de novo* action in superior court.

[2] A *de novo* action is one that is tried as if no decision had been previously rendered.

After being provided with a detailed overview of the current tax appeals and refund system, the Committee heard from representatives of the Council on State Taxation (COST)[3] as well as members of the Tax Council of the North Carolina Bar Association. Among the concerns expressed to the Committee were the following:

- The current system is confusing and overly complicated.
- The current system does not provide taxpayers with a truly impartial hearing before an independent and knowledgeable decision-maker outside the Department of Revenue without first having to pay the proposed tax liability.
- The current 30-day time period for requesting a hearing on a proposed notice of assessment does not provide taxpayers with sufficient time to fully understand the nature of the assessment, to seek counsel if so desired, and to respond appropriately.

The Committee also heard from the Department of Revenue. Linda Millsaps, Assistant Secretary for Tax Administration, emphasized three main points with regard to tax appeals. First, the Department wants to ensure that taxpayers have the right to be heard in a fair and adequate hearing. Second, the Department believes taxpayers should not be treated differently based on their resources. Third, the Department does not believe the current system is broken. The Department did, however, recommend that clarifying, statutory changes be made to more accurately describe the existing administrative practice whereby an Assistant Secretary of the Department, and not the Secretary, serves as the Department's hearings officer.

After hearing testimony from both sides of the issue, the Committee was presented with a proposal to modify the current tax appeals process. This proposal is attached as Appendix E. This proposal was drafted with three principles in mind:

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[3] See Appendix D, Testimony of Joseph R. Crosby, Legislative Director, Council on State Taxation to the Revenue Laws Study Committee.

simplicity, fairness, and an emphasis on informal resolution. The proposal makes the following substantive changes to the law:

- Establishes the Office of Administrative Hearings as the forum for independent review of disputed tax matters.
- Provides that a taxpayer does not have to pay a proposed tax liability in order to obtain an independent hearing on the merits, but would have to pay in order to obtain judicial review of a decision resulting from that independent hearing.
- Eliminates the Tax Review Board.
- Expands the jurisdiction of the North Carolina Business Court to include tax cases.
- Lengthens from 30 days to 45 days the time period for objecting to a proposed assessment.

The Committee heard from both sides regarding the merits of the proposal. Bill Nelson and Jody Joyner, who are members of the Tax Council of the North Carolina Bar Association, each addressed the Committee and indicated that the proposal was a vast improvement over the current system and a step in the right direction. They reported to the Committee that the tax appeals system has been an issue under consideration by the Tax Council for several years. Other members of the Council submitted letters supporting the proposal, which are attached as Appendix F.

The Committee also heard from Secretary Tolson who testified that the proposal would lengthen the overall process, require taxpayers to hire legal representation, and result in taxpayers feeling dissatisfied with the process. He also stressed to the Committee that, during his tenure, he has never had any communications with the hearings officer regarding any case.

The issue of disputed tax matters has been studied by this Committee on several occasions within the last five years. The Committee acknowledged that this issue is an extremely complex one presenting difficult policy choices, and that it has taken significant steps forward with its review of this proposal. However, given the lack of time to develop consensus, the Committee did not make a recommendation but expressed confidence that the issue would be further developed during the legislative session.

Taxes 'Paid Under Protest'

For the second time in four years, the Committee studied the tax refund procedure and focused on the appropriate legislative response to recent judicial interpretations of the payment under protest statute. Specifically, the Committee was apprised of a Court of Appeals decision in the ongoing *Dunn v. State of North Carolina* case in which the court significantly and somewhat surprisingly broadened the protest statute, effectively rendering it meaningless.[4] In the most recent case prior to *Dunn* interpreting this statute, the *Bailey II* Court said that the requirement to file a written demand prior to filing suit was only required to the extent the State has notice of its potential fiscal liability. The *Dunn* Court went even further stating that as long as the State had notice that a tax was being challenged, the requirement was met and the burden was on the State to figure out its potential liability.

As the result of presentations at four of the Committee's six meetings, the Committee concluded that, with respect to constitutional refund claims, the current law is unclear, a trap for the unwary taxpayer, and potentially places the State in a precarious fiscal position with regard to planning for future tax refunds. As a result, the Committee recommends Legislative Proposal 2, *Uniform Tax Refund Procedure*.

[4] See section of this report entitled, 'Case Law Update' for a more detailed discussion of the *Dunn* case.

Legislative Proposal 2 does the following:

- Consolidates the tax refund process into a single, uniform procedure regardless of the nature of the refund request.
- Changes the statute of limitations period for filing (1) a demand for refund, and (2) a civil action after the denial of a refund claim.
- Limits class actions for tax refunds to only those taxpayers who have filed a written demand for a refund.

The Committee recognizes that this proposal is a first step in attempting to clarify the current refund procedure and anticipates that it will need substantial development during the legislative session. The Committee considered several possible amendments to the proposal at its last meeting and decided to leave the amendments as issues to be considered in the development of the legislation. The Committee supports the consolidation of the refund process into a single, uniform procedure; this proposal reflects that support. The proposal also reflects the recognition that the legislature needs to clarify the procedure for challenging the constitutionality of a tax, particularly when those challenges involve a class action.

IRC UPDATE

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[5] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[6] Updating the Internal Revenue

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[5] North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

[6] 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."

Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. Legislative Proposal 3, *IRC Update*, changes the statutory reference to the Code from January 1, 2006, to January 1, 2007. Between those dates, Congress enacted five pieces of federal legislation that made changes to the Internal Revenue Code. This federal legislation includes the Deficit Reduction Act of 2005 (P.L. 109-71) signed into law February 9, 2006, the Tax Increase Prevention and Reconciliation act of 2005 (P.L. 109-222) signed into law May 18, 2006, the Heroes Earned Retirement Opportunities Act (P.L. 109-227) signed into law May 23, 2006, the Pension Protection Act of 2006 (P.L. 109-280) signed into law August 19, 2006 and the Tax Relief and Health Care Act of 2006 (P.L. 109-432) signed into law December 20, 2006.

CONSERVATION TAX CREDIT

The Revenue Laws Study Committee reviewed the conservation tax credit this year. In particular, the Committee discussed the issue of how the tax credit differs between corporate and pass-through entity taxpayers, the issue of which types of property qualify for a tax credit under the statute, and the issue of increasing the accuracy of represented fair market values for donated property. The conservation tax credit is a credit given to taxpayers who donate real property in North Carolina useful for conservation purposes. The credit, taken against income tax, is equal to 25% of the fair market value of the donation. Prior to January 1, 2007, the credit was capped for individuals other than pass-through entities at $250,000 and for corporations at $500,000. Pass-through entities had no cap for the entity as a whole, but each member's credit for qualifying donations was capped at $250,000. Anecdotal evidence suggested some disagreement between the departments of the Environment and Natural Resources and Revenue as to what types of land should qualify for conservation purposes under the statutory language "other similar land use purposes" and also indicated some instances of taxpayers receiving tax credits for land based on inaccurate fair market value representations. Legislative Proposal 4, *Tax Credit for Real Property Donations*, modifies the conservation tax credit in the following ways:

- It increases the tax cap for pass-through entities from $250,000 to $500,000 and provides that the cap applies to the pass-through entity as a whole.
- It eliminates "other similar land use purposes" in favor of six specific uses.
- It requires certain appraisal report documentation to support the represented fair market value of the donation.

STREAMLINED SALES TAX CHANGES

The Revenue Laws Study Committee has spent a considerable amount of time over the past several years on the Streamlined Sales Tax Project, which began in March 2000. The Streamlined Sales Tax Project is an effort by states, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The goal of the Project is to achieve sufficient simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in participating states.

In November 2002, the implementing states approved the Streamlined Sales and Use Tax Agreement. The Agreement contains the uniformity and simplification provisions developed by the Project. In July 2005, the Agreement became effective when 18 states representing 28% of the population of states imposing a sales tax were found to be in compliance with the terms of the Agreement. On October 1, 2005, the Streamlined Sales Tax Governing Board, Inc. came into existence. The Governing Board consists of representatives of the member states.[7] It oversees administration of the

[7] As of January 2007, there are 21 states represented on the Governing Board.

Agreement. North Carolina is one of the full member states because the General Assembly, upon the recommendation of the Revenue Laws Study Committee, has enacted the necessary changes to North Carolina's sales tax laws to bring it into compliance with the Agreement.

Legislative Proposal 5, *Streamlined Sales Tax Changes,* makes two definitional changes the State must adopt by January 1, 2008, in order to continue to comply with the latest amendments to the Streamlined Sales Tax Agreement. One change is to add a definition of 'bundled transaction' and specify how these transactions are to be taxed. The other change is to modify the definition of 'sales price' to clarify how third-party discounts, such as a manufacturer's coupon, affect the sales price of an item. The legislative proposal also updates the reference to the Streamlined Sales Tax Agreement to include the latest amendments to that Agreement and it clarifies that anyone who relies on the taxing jurisdiction database developed by the Department to determine the rate of sales tax applicable in a jurisdiction is not liable for any tax underpayments attributable to reliance on that database. This is the result under current law because the database is a written statement of the Department under G.S. 105-264.

Legislative Proposal 5 makes one change that is unrelated to the Streamlined Sales Tax Agreement. It revises the sales tax exemption for items sold for use in commercial fishing to insert references to a holder of a commercial fishing license, a commercial shellfish license, and the operator of a for-hire boat. The reference to the operator of a for-hire boat is an addition to the statute, but reflects the administrative practice of including this group in the commercial fishing group.

GIFT TAX SIMPLIFICATION

The Revenue Laws Study Committee studied North Carolina's gift tax this year. Discussion of the gift tax highlighted the facts that North Carolina is one of only four states that imposes a gift tax and that there is little similarity between the North Carolina and federal gift taxes. The North Carolina gift tax is not unified with the estate tax and is applied differently based on the relationship between the donor and donee. The federal gift tax is part of a unified system with the estate tax and, for the most part, is applied uniformly regardless of the relationship between the donor and donee. The Committee decided to reform the State gift tax to more closely conform it to the federal tax. The results of the Committee's efforts are attached as Legislative Proposal 6, *Gift Tax Simplification*.

ADDITIONAL GROSS PREMIUMS TAX ON CONTRACTS THAT PROVIDE PROPERTY COVERAGE

Last session the General Assembly, upon the recommendation of the Revenue Laws Study Committee, clarified the current application of the additional gross premiums tax on fire and lightning policies and, effective January 1, 2008, simplified the application of the tax by broadening the tax base to apply to all insurance policies that provide property coverage. Twenty-five percent of the additional statewide tax on fire and lightning policies is credited to the Volunteer Fire Department Fund,[8] and the remainder is credited to the General Fund. There is also an additional local tax applied to gross premiums on insurance policies that provide fire and lightning coverage within fire districts. Ninety-five percent of the net proceeds of this local tax are credited to the local fire districts.

S.L. 2006-196 replaced the additional State and local tax on fire and lightning policies with an additional statewide tax on insurance policies that provide property coverage, effective for taxable years beginning on or after January 1, 2008. The act

[8] Funds in the Volunteer Fire Department Fund provide matching grants to volunteer fire departments to purchase equipment and make capital improvements. In 2005, the Department received 567 applications for grants requesting matching funds of $6,577,455. The available monies in the Fund totaled only $4,369,976. The Department approved 500 applications totaling $4,365,489.

extended the tax base from policies that provide fire and lightning coverage to policies that provide property coverage, including automobile property coverage, because fire departments respond to calls concerning property coverage, not just to fire calls. The 2006 act also reduced the applicable tax rate, effective January 1, 2008, to a revenue-neutral rate of 0.85%. The Committee continued to study the rate to ensure that it was the revenue-neutral rate. After much study, the revenue neutral rate has been determined to be 0.74%. Legislative Proposal 8, *Additional Tax on Property Coverage Contract,* changes the rate accordingly.

The revenue generated by the additional tax on property coverage contracts is distributed in the same proportion as the current State and local fire and lightning tax revenue is distributed. Under the current method of taxation, the additional local tax rate applies only to policies issued in fire districts and 95% of the tax collected is distributed to those fire districts in which it is collected. Under the change that becomes effective in 2008, the local tax is eliminated in favor of the broader statewide tax. The 2006 legislation established a new method of distribution to the local fire districts based upon a per capita allocation among the fire districts. Upon further review, this method of distribution does not appear to ensure a distribution of revenues that is similar to the current distribution. Legislative Proposal 8 changes the method of distribution so that the amount of revenue distributed to a local fire district is based upon the amount received by it in the preceding year.

As the Committee discussed this proposal, the Commissioner of Insurance asked it to consider increasing the revenues available to the Volunteer Fire Department Fund. The Department of Insurance receives more applications for requests than the Fund can grant. To address the Commissioner's concerns, Legislative Proposal 8 changes the current distribution between the General Fund and the Volunteer Fire Department Fund so that the Volunteer Fire Department Fund will receive approximately $3 million in additional revenue. It also changes some of the grant program requirements so that more volunteer fire departments may qualify for grants from the Fund.

PROPERTY TAX

The Revenue Laws Study Committee spent some time considering two different property tax issues.

Property Tax on Motor Vehicles

The Committee began its discussion of the property tax on motor vehicles with an overview of the current system for paying property taxes and registration fees on motor vehicles, followed by a discussion of the changes to that system made by S.L. 2005-294, AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM. (See Appendix G). The 2005 legislation provides for a combined computer system that will require payment of property taxes and registration fees on the same date. The goals of the combined system are to reduce the number of taxpayer interactions with government, to save the State and local governments' money by requiring only one billing, and to provide the counties with a more efficient property tax collection system while holding the Division of Motor Vehicles fiscally harmless. During the 2006 Session, two changes were made to the 2005 act:

- Clarifying changes were enacted to reflect the intent of the sponsors and supporters of the combined system.
- The effective date of the new system was moved from July 1, 2009 to July 1, 2010.

A task force was formed to determine how best to implement the new combined system. David Baker, Director of the Property Tax Division in the Department of Revenue, and Stephanie King, Director of Accounting Operations of the Division of Motor Vehicles in the Department of Transportation, reported to the Committee twice on the task force's progress. They stressed that the task force is continuing to meet monthly to resolve issues raised by the legislation. The task force is considering issues such as credit card usage, payment of tag agents, unregistered vehicles, payment of the new system, and the role of car dealers. The task force plans to visit the Georgia Department of Revenue to examine Georgia's system of combining taxes and fees on motor vehicles. The task force did not make any legislative recommendations to the Committee.

Property Taxation of Conservation Lands

The Committee spent some time discussing the property tax valuation of conservation land. Representatives of conservation organizations stressed a need for tax incentives for voluntary wildlife conservation, including a lower tax value for land held in a conservation easement, and for improving consistency among the counties in implementing the present-use value system for farmland. (See Appendix H). Stan Duncan, Henderson County Tax Assessor, explained how property subject to a conservation easement is appraised and assessed for property tax purposes. (See Appendix I). Duncan questioned the need for legislation in this area since current law requires that any determination of the value of property subject to a conservation easement must consider the advantages and disadvantages of conservation preservation agreements. Pete Rodda, Forsyth County Tax Assessor, presented the Committee with data showing the total deferred value for properties classified as present-use value in the State for 2005. He stressed that present-use value deferral is the single largest form of property tax exemption after government exemptions. (See Appendix J). All parties stressed the importance of revenue neutrality when looking at expanding tax benefits to wildlife land. Examples of how other states have updated their present-use value system while ensuring revenue neutrality for the counties was discussed. (See Appendix K). The speakers were instructed by the Co-chairs of the Committee to work together to try and come up with a consensus on these issues.

The Committee's staff met three times with the interested parties and looked at various ways of providing tax benefits to conservation lands. The proposals included an income tax credit as well as property tax relief for property used for conservation purposes. After reviewing these proposals, the Co-chairs determined that the Revenue Laws Committee was not ready to make a recommendation. Specifically, the Co-chairs cited a lack of unanimity for the proposals from the interested parties, constitutional concerns with at least one of the proposals, and the advantages occasioned by first having a conservation legislative committee study both the land that would benefit from the proposals and the overall effect of the proposals.

CASE LAW UPDATE

The Revenue Laws Study Committee continues to monitor ongoing court cases involving matters that have the potential to affect the State's budget and revenue outlook. At its November meeting, the Committee heard an update on the *Dunn v. State of North Carolina* case. A more detailed analysis of this case, which was distributed at the meeting, is attached as Appendix L. *Dunn* is one of three cases nationwide challenging state tax exemptions for interest income derived from obligations issued by other states. The case is significant because it could have a profound impact on the municipal bond market, both locally and nationwide, it could result in a significant revenue loss if the State is required to issue refunds to holders of out-of-state bonds, and it could foreshadow future litigation over similar preferential tax exemptions for in-state activity.

In the Kentucky case, the Kentucky Court of Appeals held that the exemption is unconstitutional because it discriminates against interstate commerce by affording more favorable taxation treatment to in-state bonds than to out-of-state bonds. The Kentucky Supreme Court declined to hear the case, surprising many commentators. The state has filed a petition for review with the United States Supreme Court. The Kentucky case is relevant to North Carolina because it involves the same issue as the Dunn case and is further along in the litigation process. Dunn could be stayed pending the outcome of the Kentucky case.

With regard to the current procedural posture of Dunn, the superior court certified the case as a class action and the State appealed the order certifying the class. On October 17, 2006, the North Carolina Court of Appeals upheld the order. The State has appealed to the North Carolina Supreme Court. This appeal, however, does not involve the merits of the case.

ENHANCE COLLECTION PROCEDURES

The Department of Revenue requested the Revenue Laws Study Committee to consider enhancing its collection enforcement tools in three ways:

- To allow the Department, through one of its revenue officers, to levy upon and sell real property owned by a delinquent taxpayer. A revenue officer has the ability under current law to levy upon personal property. To levy upon real property requires the Department to issue a warrant to the sheriff of the county where the property is located.
- To allow the Department to use its administrative assessment process to hold garnishees liable for amounts that they failed to withhold and remit to the Department.
- To require that professional licenses provided by the North Carolina Examining and Licensing Boards be suspended if the taxpayer is not compliant with the State tax statutes regarding filing or payment of taxes.

The Committee commended the Department on its collection efforts. It discussed the requests, but decided not to recommend any legislation in this area at this time.

COMMITTEE RECOMMENDATIONS
AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee makes the following eight recommendations to the 2007 General Assembly. Each proposal is followed by an explanation and, if it has a fiscal impact, a fiscal note or memorandum, indicating any anticipated revenue gain or loss resulting from the proposal.

1. Modernize Corporate Income Tax Filing
2. Uniform Tax Refund Procedure
3. IRC Update
4. Conservation Tax Credit Modifications
5. Streamlined Sales Tax Changes
6. Gift Tax Simplification
7. Additional Tax on Property Coverage Contract
8. Revenue Laws and Motor Fuels Tax Technical Changes

LEGISLATIVE PROPOSAL #1

MODERNIZE CORPORATE INCOME TAX FILING

LEGISLATIVE PROPOSAL #1

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO REQUIRE CORPORATIONS TO FILE A COMBINED INCOME TAX REPORT.

SHORTT TITLE: Modernize Corporate Income Tax Filing.

SPONSORS:

BRIEF OVERVIEW: This proposal would change the way North Carolina determines the net income of a corporation. Under current law, a corporate files as a separate entity. Under this proposal, a corporation that is part of an affiliated group engaged in a single trade or business would file a combined report and its net income would be based upon the combined income of the group apportioned to this State.

FISCAL IMPACT: No fiscal estimate available at publication. The Department of Revenue's Tax Research Division and the General Assembly's Fiscal Research Division continue in a cooperative effort to develop an estimate for this proposal.

EFFECTIVE DATE: This act would become effective for taxable years beginning on or after January 1, 2009.

A copy of the proposed legislation and a bill analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2007

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BILL DRAFT 2007-RBxz-3 [v.10] (01/10)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/22/2007 7:26:49 PM

Short Title: Modernize Corporate Income Tax Filing.	(Public)
Sponsors: .	
Referred to:	

A BILL TO BE ENTITLED

AN ACT TO REQUIRE CORPORATIONS TO FILE A COMBINED INCOME TAX REPORT.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-130.2(5c) reads as rewritten:

"**§ 105-130.2. Definitions.**

The following definitions apply in this Part:

…

(5c) State net income. – The taxpayer's federal taxable income as determined under the Code, adjusted as provided in G.S. 105-130.5 and, in the case of a corporation that has income from business activity that is taxable both within and without this State, allocated and apportioned to this State as provided in G.S. 105-130.4. A corporation's net income in this State includes all of the following:

a. Its share of any income apportionable to this State of each of the combined groups of which it is a member.

b. Its share of any income apportionable to this State of a distinct business activity conducted within or without the State wholly by the taxpayer.

c. Its income from a business conducted wholly by the taxpayer entirely within this State.

d. Its nonapportionable income or loss allocable to this State."

SECTION 2. G.S. 105-130.4(a) reads as rewritten:

"**§ 105-130.4. Allocation and apportionment of income for corporations.**

(a) ~~As used in this section, unless the context otherwise requires:~~The following definitions apply in this section, G.S. 105-130.4A, and G.S. 105-130.4B:

(1) ~~"Apportionable income" means all~~ Affiliated group. – A group of two or more corporations in which more than fifty percent (50%) of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member corporations.

(1a) Apportionable income. – All income that is apportionable under the United States Constitution.

(1b) Business activity. – Any activity by a corporation that would establish nexus under 15 Unites States Code section 381.

(1c) Casual sale of property. – The sale of any property which was not purchased, produced or acquired primarily for sale in the corporation's regular trade or business.

(1d) Combined group. – The collective members of an affiliated group that are engaged in a unitary business.

(2) ~~"Commercial domicile" means the~~ Commercial domicile. – The principal place from which the trade or business of the taxpayer is directed or managed.

(3) ~~"Compensation" means wages,~~ Compensation. – Wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(4) ~~"Excluded corporation" means any~~ Excluded corporation. A corporation engaged in business as a building or construction contractor, a securities dealer, or a loan company or a corporation that receives more than fifty percent (50%) of its ordinary gross income from intangible property.

(5) ~~"Nonapportionable income" means all~~ Nonapportionable income. – All income other than apportionable income.

(6) ~~"Public utility" means any~~ Public utility. – A corporation that is subject to control of one or more of the following entities: the North Carolina Utilities Commission, the Federal Communications Commission, the Interstate Commerce Commission, the Federal Energy Regulatory Commission, or the Federal Aviation Agency; and that owns or operates for public use any plant, equipment, property, franchise, or license for the transmission of communications, the transportation of goods or persons, or the production, storage, transmission, sale, delivery or furnishing of electricity, water, steam, oil, oil products, or gas. The term also includes a motor carrier of property whose principal business activity is transporting property by motor vehicle for hire over the public highways of this State.

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

a. Receipts from a casual sale of property.

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

c. Receipts exempt from taxation.

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

(8) ~~"Casual sale of property" means the sale of any property which was not purchased, produced or acquired primarily for sale in the corporation's regular trade or business.~~

(9) ~~"State" means any~~ State. – A state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(10) Unitary business. – One or more related business organizations engaged in business activity both within and without the State among which one or more of the following exist:

a. A unity of ownership, operation, or use.

b. An interdependence in their functions.".

SECTION 2. G.S. 105-130.4(b) reads as rewritten:

"(b) A corporation having income from business activity which is taxable both within and without this State shall allocate and apportion its net income or net loss as provided in this ~~section.~~ section and G.S. 105-130.4A. For purposes of allocation and apportionment, a corporation is taxable in another state if (i) the corporation's business activity in that state subjects it to a net income tax or a tax measured by net income, or (ii) that state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless whether that state exercises its jurisdiction. ~~For purposes of this section, "business activity" includes any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code section 381.~~"

SECTION 3. G.S. 105-130.4(i) reads as rewritten:

"(i) All apportionable income of corporations other than public utilities and excluded corporations shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. Provided, that where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus one. The apportionable income of a corporation that is part of a combined group engaged in a unitary business shall be apportioned to this State as provided in G.S. 105-130.4A."

SECTION 4. G.S. 105-130.4(l)(2) reads as rewritten:

"(2) Sales of tangible personal property are in this State if the property is received in this State by ~~the purchaser.~~ a purchaser other than the United States government. In addition, a sale of tangible personal property is in this State if the property is shipped from a place in this State and the purchaser is in the United States government or the taxpayer is not taxable in the state of the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed shall be considered as the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State shall constitute delivery to the purchaser in this State."

SECTION 5. Part 1 of Article 4 of Chapter 105 of the General Statutes is amended by adding two new sections to read:

"**§ 105.130.4A. Apportionment of income of combined group.**

(a) Combined Group. – The apportionable income of a combined group's unitary business is determined by eliminating income, deductions, and losses from all transactions between the members of the combined group associated with the combined group's unitary business. The apportionable income of the combined group's unitary business is apportioned in accordance with G.S. 105-130.4(i) through G.S. 105-130.4(l), including in the numerator the property, payroll, and sales associated with the combined group's unitary business in this State of each member of the combined group that has business activity in this State associated with the combined group's unitary business and including in the denominator the property, payroll, and sales of all members of the combined group that are associated with the combined group's unitary business. Members of a combined group may elect to determine the combined group's apportionable income pursuant to water's edge election under G.S. 105-130.4B.

(b) Member Share. – A member's share of the apportionable income of a combined group's unitary business apportioned to this State of which it is a member is the product of the following:

(1) The apportionable income of the combined group's unitary business apportionable to this State.

(2) The ratio of the member's State apportionment factors associated with the combined group's unitary business to the combined group's aggregate State apportionment factors associated with the combined group's unitary business."

"**§ 105-130.4B. Water's edge election.**

(a) Election. –Members of a combined group may elect to disregard the income and apportionment factors of a member of the combined group that is a foreign corporation that conducts eighty percent (80%) or more of its business activity outside the United States and outside of a tax haven country. A water's edge election must be filed in writing with the Secretary. It is effective for the taxable year in which it is filed and for the following 10 taxable years. The election will be automatically extended at the end of the 10-year period unless notice is given in writing to the Secretary of intent not to renew. The notice of intent not to renew must be made before the end of the last two years of the election period.

(b) Withdrawal of Election. – An election may be withdrawn only upon written request to the Secretary and only with the written permission of the Secretary. If the Secretary grants a withdrawal of election, the Secretary must impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal. A water's edge election, once terminated by either a notice of withdrawal or a failure to renew, may not be renewed for a minimum of three years.

(c) Definition. – For purposes of this section, the term 'tax haven country' has the same meaning as in G.S. 143-59.1.

SECTION 6. G.S. 105-130.14 reads as rewritten:

"**§ 105-130.14. ~~Corporations filing consolidated returns for federal income tax purposes.~~Combined reporting.**

~~Any corporation electing or required to file a consolidated income tax return with the Internal Revenue Service shall not file a consolidated return with the Secretary of Revenue, unless specifically directed to do so in writing by the Secretary, and shall determine its State net income as if a separate return had been filed for federal purposes.~~

A corporation which is part of an affiliated group engaged in a unitary business must file a report for the combined group containing the combined net income of the combined group and any other information the Secretary may require. The use of a combined report does not disregard the separate identities of the members of the combined group. Each member of the combined group is responsible for tax based on its taxable income or loss apportioned or allocated to this State."

SECTION 7. This act becomes effective for taxable years beginning on or after January 1, 2009.

BILL ANALYSIS

BILL DRAFT 2007-RBxz-3: Modernize Corporate Income Tax Filing

Committee:	Revenue Laws Study Committee	**Date:**	January 23, 2007
Introduced by:		**Summary by:**	
Version:	Draft		

***SUMMARY:** Draft 2007-RBxz-3 would change the way North Carolina determines the net income of a corporation. Under current law, a corporation files as a separate entity. Under this proposal, a corporation that is part of an affiliated group engaged in a single trade or business would file a combined report and its net income would be based upon the combined income of the group apportioned to this State. The proposal would become effective for taxable years beginning on or after January 1, 2009.*

CURRENT LAW: To determine its State net taxable income, a corporation must begin with its federal taxable income. Multistate corporations may file a consolidated federal return. However, under North Carolina law, a corporation may not file a consolidated return unless specifically required to do so by the Secretary of Revenue. North Carolina requires corporations to file as a separate entity, meaning it must determine its State net income as if a separate return had been filed for federal income tax purposes.

Separate entity filing gives corporations with subsidiaries in multiple states the ability to devise ways to shift income from a high effective tax rate state to a low effective tax rate state, often through the use of passive investment companies and intercompany transactions. Over the past several years, the General Assembly has enacted changes to the State's corporate income tax laws to address the shifting of income between states of multistate corporations. In 2001, the State enacted the royalty income reporting option. That legislation provided that income from using trademarks in this State is taxable to this State, regardless of where the corporation that holds the trademark is located. That legislation has been 'tweaked' and expanded since 2001, but the problem of income shifting between multistate corporations continues to be an issue. The Department of Revenue has the ability to require a corporation to file a consolidated return when it believes the corporation's true net income attributable to this State is not accurately reflected on its separate entity filing return.

A more comprehensive way to address the issue of income shifting between affiliated corporations is through the use of combined reporting. The Governor's Commission to Modernize State Finances recommended this change in 2001. The Multistate Tax Commission adopted a model uniform statute for combined reporting in 2006. Seventeen states currently require combined reporting.[*]

BILL ANALYSIS: This proposal would require mandatory combined reporting. Combined reporting is a method of calculating the income of a group of related corporations for tax purposes. It looks beyond the legal structure of separate incorporations to determine whether two or more related corporations are engaged in a single unitary business. Mandatory combined reporting would ensure that the income of a multistate corporation is computed and apportioned in the same manner as a single corporate business.

[*] Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kentucky, Maine, Minnesota, Montana, Nebraska, New Hampshire, North Dakota, Oregon, Utah, and Vermont. Vermont adopted its law in 2004, effective for taxable years beginning on or after January 1, 2006.

A combined report is not a tax return. It is an accounting document prepared on behalf of a group of affiliated corporations engaged in a unitary business. Only those members of a unitary group that have nexus with North Carolina pay corporate income tax to North Carolina; however, the net income of the corporation is based on the combined group's net income apportioned to this State.

The proposal would require a corporation that is part of an affiliated group engaged in a unitary business to file a combined report. For purposes of filing a combined report, an affiliated group is defined as a group of two more corporations in which more than 50% of the voting stock of each member corporation is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member corporations. The term 'unitary business' is defined as one or more related business organizations engaged in business activity both within and without the State among which one or more of the following exist:

- A unity of ownership, operation, or use.
- Interdependence in their functions.

The proposal would require that all corporations that are part of an affiliated group engaged in a unitary business be part of the combined report – that would include a group member that is a non-US corporation. However, the proposal would give the taxpayer the option of electing to exclude a group member whose business activity outside the United States is 80% or more of its total business activity. This election is commonly referred to as a 'water's edge election.' If a corporation chooses water's edge election, then the members of the group that would be include in a combined report include the following:

- U.S. corporations
- Non-U.S. corporations whose business activity inside the United States is 20% or more of its total business activity.
- Corporations doing business in a tax haven country, as defined in G.S. 143-59.1.[†]
- Related intangible holding companies.

A corporation desiring to make water's edge election would need to do so in writing and the election would be binding for 10 years. An election would be automatically extended unless notice is given of intent not to renew before the end of the last two years of the election period. An election terminated could not be renewed for a minimum of three years. An election could be terminated prior to the 10-year period if requested in writing and approved by the Secretary of Revenue.

Under this proposal, a corporation's net income in this State would include all of the following:

- Its share of any income apportionable to this State of each of the combined groups of which it is a member.
- Its share of any income apportionable to this State of a distinct business activity conducted within or without the State wholly by the taxpayer.
- Its income from a business conducted wholly by the taxpayer entirely within the State.
- It non-apportionable income or loss allocable to this State.

OUTSTANDING ISSUES: The proposal seeks to provide a vehicle through which the 2007 General Assembly can begin discussing the merits of combined reporting. The proposal does not address all of the issues that would need to be addressed if this tax law change is enacted. Some of the outstanding issues that will need to be decided include the following:

- The fiscal impact. – The Tax Research Division of the Department of Revenue, in cooperation with the analysts in the Fiscal Research Division, continues to work on an estimate for this proposal. If the proposal results in an increase in the corporate income tax,

[†] G.S. 143-59.1 defines a tax haven country as one or more of the following: Barbados, Bermuda, British Virgin Islands, Cayman Islands, Commonwealth of the Bahamas, Gibraltar, Isle of Man, the Principality of Monaco, and the Republic of the Seychelles.

the General Assembly could make a policy decision to lower the corporate income tax rate to a sufficient level to make the change revenue-neutral.

- Excluded corporations. – Which, if any, corporations should be excluded from combined reporting?
- Special apportionment formulas. – Current law provides special apportionment formulas for certain taxpayers, such as public utility companies. How will combined reporting affect the special apportionment formulas?
- Franchise tax. – What should the relationship be between the corporate income tax and the corporate franchise tax? Should combined reporting be used for franchise tax purposes also?
- Transitional issues.
- Administrative and compliance issues.

LEGISLATIVE PROPOSAL #2

UNIFORM TAX REFUND PROCEDURE

LEGISLATIVE PROPOSAL #2

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO ESTABLISH A UNIFORM PROCEDURE FOR TAX REFUND CLAIMS.

SHORT TITLE: Uniform Tax Refund Procedure.

SPONSORS:

BRIEF OVERVIEW: This proposal would:

- Consolidate the tax refund process into a single, uniform procedure regardless of the nature of the refund request.
- Change the statute of limitations period for filing (1) a demand for a refund, and (2) a civil action after the denial of a refund claim.
- Limit class actions for tax refunds to only those taxpayers who have filed a written demand for a refund.

FISCAL IMPACT: No fiscal impact available at publication.

EFFECTIVE DATE: This act would become effective January 1, 2008, and apply to taxes paid on or after that date.

A copy of the proposed legislation and a bill analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

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BILL DRAFT 2007-SVz-2A [v.9] (12/06)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/24/2007 3:44:24 PM

Short Title: Uniform Tax Refund Procedure. **(Public)**

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ESTABLISH A UNIFORM PROCEDURE FOR TAX REFUND CLAIMS .

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-266 and G.S. 105-266.1 are repealed.

SECTION 2. Article 9 of Chapter 105 is amended by adding a new section to read:

"**§ 105-265.1. Refunds of overpayment of taxes.**

(a) Without Demand. – If the Secretary discovers that a taxpayer has overpaid the correct amount of a tax, the overpayment must be refunded to the taxpayer as soon as possible together with any applicable interest. The Secretary may issue a refund of an overpayment only after the taxpayer has filed the final return for the tax period.

(b) Upon Demand. – A taxpayer who claims to have overpaid a tax may file a demand for a refund with the Secretary. The taxpayer must file the demand within the statute of limitations set out in G.S. 105-265.2. A demand for refund must be in a form prescribed by the Secretary and must identify the taxpayer, the type and amount of tax overpaid, the period included, and the reasons for the refund, including law or other authority upon which the taxpayer relies. The Secretary must either grant or deny the demand for a refund within six months from the date the demand is filed, unless this period is extended by written agreement of the taxpayer and the Secretary. The Secretary must notify the taxpayer of the decision to grant or deny the refund demand and must issue or adjust the refund, if applicable, in accordance with the decision. If the Secretary fails to grant a refund within the six-month period, the demand for refund is deemed denied.

(c) Hearing. – A taxpayer who receives a written decision from the Secretary denying a refund demand may file a written request for a hearing before the Secretary at any time within 30 days after the date the decision was mailed. A taxpayer whose demand for refund is deemed denied may file a written request for a hearing at any time within 60 days after the expiration of the six-month period set out in subsection (b) of this section. The Secretary must grant a hearing on each timely demand for a hearing. Within 60 days after a timely demand for a hearing has been filed and at least 10 days before the date set for the hearing, the Secretary shall notify the taxpayer in writing of the time and place at which the hearing will be conducted. The date set for the hearing shall be within 90 days after the timely request for a hearing was filed or at a later date mutually agreed upon by the taxpayer and the Secretary. The date set for the hearing may be postponed once, at the request of the taxpayer or the Secretary, for a period of up to 90 days or for a longer period mutually agreed upon by the taxpayer and the Secretary. The rules of evidence do not apply in a hearing before the Secretary under this section.

Within 90 days after conducting a hearing under this subsection, the Secretary must make a decision on the refund demand, notify the taxpayer of the decision, and adjust the computation of the tax in accordance with the decision. The Secretary must refund to the taxpayer in accordance with this Article the amount of any overpayment of tax.

(d) Civil Action. – Instead of requesting a hearing in accordance with subsection (c) of this section, a taxpayer may within 90 days of the denial of a refund demand bring a civil action against the Secretary for recovery of the alleged overpayment. No suit shall be maintained in any court for the recovery of any overpayment of tax unless the taxpayer seeking a refund has filed a written demand for a refund in accordance with subsection (b) of this section and the Secretary has denied the demand for refund.

If upon the trial it is determined that all or part of the tax constituted an overpayment, judgment shall be rendered therefor, with interest, and the judgment shall be collected as in other cases. The amount of taxes for which judgment is rendered shall be refunded by the State. The court may not order in its judgment the issuance of a refund to any taxpayer who has not filed a written request for a refund in accordance with this section.

(e) Venue. – If the alleged overpayment is more than two hundred dollars ($200.00), the taxpayer may bring the action either in the Superior Court of Wake County or in the superior court of the county in which the taxpayer resides; if the alleged overpayment is two hundred dollars ($200.00) or less, the taxpayer may bring the action in any State court of competent jurisdiction in Wake County.

(f) Limitation on Class Actions. – No class action for a refund of overpayment of tax may be maintained in any court unless each taxpayer in the class has filed a written demand for a refund in accordance with subsection (b) of this section.

(g) Appeal. – Either party may appeal to the appellate division from the judgment of the superior court under the rules and regulations prescribed by law for appeals, except that if the Secretary appeals, the Secretary is not required to give any undertaking or make any deposit to secure the cost of the appeal.

(h) Refunds Prohibited. – The Secretary may not refund any of the following:

(1) An overpayment set off under Chapter 105A, the Setoff Debt Collection Act, or under another setoff debt collection program authorized by law.

(2) An income tax overpayment the taxpayer has elected to apply to another purpose as provided in this Article.

(3) An individual income tax overpayment of less than one dollar ($1.00) or another tax overpayment of less than three dollars ($3.00), unless the taxpayer makes a written demand for the refund."

SECTION 3. Article 9 of Chapter 105 is amended by adding a new section to read:

"**§ 105-265.2. Statute of limitations for refunds.**

The period in which a refund must be demanded or discovered under this Article is determined as follows:

(1) General Rule. – No overpayment shall be refunded, whether upon discovery or receipt of written demand, if the discovery is not made or the demand is not received within three years after the date set by the statute for the filing of the return or within six months after the payment of the tax alleged to be an overpayment, whichever is later. An agreement by a taxpayer to extend the time in which the Department can assess the taxpayer for an underpayment automatically extends the time in which the taxpayer can demand a refund.

(2) Worthless Debts or Securities. – Section 6511(d)(1) of the Code applies to an overpayment of the tax levied in Part 2 or 3 of Article 4 of this Chapter to the extent the overpayment is attributable to either of the following:

a. The deductibility by the taxpayer under section 166 of the Code of a debt that becomes worthless, or under section 165(g) of the Code of a loss from a security that becomes worthless.

b. The effect of the deductibility of a debt or loss described in subpart a. of this subdivision on the application of a carryover to the taxpayer.

(3) Capital Loss and Net Operating Loss Carrybacks. – Section 6511(d)(2) of the Code applies to an overpayment of the tax levied in Part 2 or 3 of Article 4 of this Chapter to the extent the overpayment is attributable to a capital loss carryback under section 1212(c) of the Code or to a net operating loss carryback under section 172 of the Code.

(4) Federal Determination. – When a taxpayer files with the Secretary a return that reflects a federal determination and the return is filed within the required time, the period in which a refund must be demanded or discovered is one year after the return reflecting the federal determination is filed or three years after the original return was filed or due to be filed, whichever is later."

SECTION 4. Article 9 of Chapter 105 is amended by adding a new section to read:

"**§ 105-265.3. Interest on refunds.**

An overpayment of tax bears interest at the rate established in G.S. 105-241.1(i) from the date that interest begins to accrue until a refund is paid. A refund sent to a taxpayer is considered paid on a date determined by the Secretary that is no sooner than five days after a refund check is mailed.

A refund set off against a debt pursuant to Chapter 105A of the General Statutes is considered paid five days after the Department mails the taxpayer a notice of the setoff, unless G.S. 105A-5 or G.S. 105A-8 requires the agency that requested the setoff to return the refund to the taxpayer. In this circumstance, the refund that was set off is not considered paid until five days after the agency that requested the refund mails the taxpayer a check for the refund.

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

(1) The date the final return was filed.

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

(3) The date of the overpayment.

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

SECTION 5. G.S. 105-267 reads as rewritten:

"**§ 105-267. ~~Taxes to be paid;~~ Limitation on suits for recovery of taxes.**

No court of this State shall entertain a suit of any kind brought for the purpose of preventing the collection of any tax imposed in this Subchapter. Whenever a person has a valid defense to the enforcement of the collection of a tax, the person shall pay the tax to the proper ~~officer,~~ officer and demand a refund in accordance with G.S. 105-265.1. ~~and that payment~~ The payment of the tax shall be without prejudice to any defense of rights the person may have regarding the tax. ~~At any time within the applicable protest period, the taxpayer may demand a refund of the tax paid in writing from the Secretary and if the tax is not refunded within 90 days thereafter, may sue the Secretary in the courts of the State for the amount demanded. The protest period for a tax levied in Article 2A, 2C, or 2D of this Chapter is 30 days after payment. The protest period for all other taxes is three years after payment.~~

~~The suit may be brought in the Superior Court of Wake County, or in the county in which the taxpayer resides at any time within three years after the expiration of the 90-day period allowed for making the refund. If upon the trial it is determined that all or part of the tax was levied or assessed for an illegal or unauthorized purpose, or was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the judgment shall be collected as in other cases. The amount of taxes for which judgment is rendered in such an action shall be refunded by the State. G.S. 105-241.2~~

~~provides an alternate procedure for a taxpayer to contest a tax and is not in conflict with or superseded by this section.~~"

SECTION 6. G.S. 105-113.113(a) reads as rewritten:

"(a) Special Account. – The Secretary shall credit the proceeds of the tax levied by this Article to a special nonreverting account, to be called the State Unauthorized Substances Tax Account, until the tax proceeds are unencumbered. The Secretary shall remit the unencumbered tax proceeds as provided in this section on a quarterly or more frequent basis. Tax proceeds are unencumbered when either of the following occurs:

(1) The tax has been fully paid and the taxpayer has no current right under ~~G.S. 105-267~~Article 9 of this Chapter to seek a refund.

(2) The taxpayer has been notified of the final assessment of the tax under G.S. 105-241.1 and has neither fully paid nor timely contested the tax under ~~G.S. 105-241.1 through G.S. 105-241.4 or G.S. 105-267.~~Article 9 of this Chapter."

SECTION 7. G.S. 105-239.1(c) reads as rewritten:

"(c) The provisions of G.S. 105-241.1, 105-241.2, 105-241.3, 105-241.4, ~~105-266.1 and 105-267~~and 105-265.1 with respect to assessment procedure, demand for refund, review, and appeal ~~shall~~ apply to the liability of any transferee assessed under this section or of any property subject to the liability imposed by this section and to the assertion of a lien upon property in the hands of the transferee."

SECTION 8. G.S. 1-52(15) reads as rewritten:

"(15) For the recovery of taxes paid as provided in ~~G.S. 105-267 and~~ G.S. 105-381."

SECTION 9. G.S. 20-99(b)(3) reads as rewritten:

"(3) Shall be accompanied by a copy of this subsection, and thereupon the procedure shall be as follows:

If the garnishee has no defense to offer or no setoff against the taxpayer, he shall, within 10 days after service of said notice, answer the same by sending to the Commissioner of Motor Vehicles by registered mail a statement to that effect, and if the amount due or belonging to the taxpayer is then due or subject to his demand, it shall be remitted to the Commissioner with said statement, but if said amount is to mature in the future, the statement shall set forth that fact and the same shall be paid to the Commissioner upon maturity, and any payment by the garnishee hereunder shall be a complete extinguishment of any liability therefor on his part to the taxpayer. If the garnishee has any defense or setoff, he shall state the same in writing under oath, and, within 10 days after service of said notice, shall send two copies of said statement to the Commissioner by registered mail; if the Commissioner admits such defense or setoff, he shall so advise the garnishee in writing within 10 days after receipt of such statement and the attachment or garnishment shall thereupon be discharged to the amount required by such defense or setoff, and any amount attached or garnished hereunder which is not affected by such defense or setoff shall be remitted to the Commissioner as above provided in cases where the garnishee has no defense or setoff, and with like effect. If the Commissioner shall not admit the defense or setoff, he shall set forth in writing his objections thereto and shall send a copy thereof to the garnishee within 10 days after receipt of the garnishee's statement, or within such further time as may be agreed on by the garnishee, and at the same time he shall file a copy of said notice, a copy of the garnishee's statement, and a copy of his objections thereto in the superior court of the county where the garnishee resides or does business where the issues made shall be tried as in civil actions.

If judgment is entered in favor of the Commissioner of Motor Vehicles by default or after hearing, the garnishee shall become liable for the taxes, interest and penalties due by the taxpayer to the extent of the amount over and above any defense or setoff of the garnishee belonging, owing, or to become due to the taxpayer, but payments shall not be required from amounts which are to become due to the taxpayer until the maturity thereof, nor shall more than ten percent (10%) of any taxpayer's salary or wages be required to be paid hereunder in any one month. The garnishee may satisfy said judgment upon paying said amount, and if he fails to do so, execution may issue as provided by law. From any judgment or order entered upon such hearing either the Commissioner of Motor Vehicles or the garnishee may appeal as provided by law. If, before or after judgment, adequate security is filed for the payment of said taxes, interest, penalties, and costs, the attachment or garnishment may be released or execution stayed pending appeal, but the final judgment shall be paid or enforced as above provided. The taxpayer's sole remedies to question his liability for said taxes, interest, and penalties shall be those provided in ~~G.S. 105-267, as now or hereafter amended or supplemented.~~ Article 9 of Chapter 105 of the General Statutes. If any third person claims any intangible attached or garnished hereunder and his lawful right thereto, or to any part thereof, is shown to the Commissioner, he shall discharge the attachment or garnishment to the extent necessary to protect such right, and if such right is asserted after the filing of said copies as aforesaid, it may be established by interpleader as now or hereafter provided by the General Statutes in cases of attachment and garnishment. In case such third party has no notice of proceedings hereunder, he shall have the right to file his petition under oath with the Commissioner at any time within 12 months after said intangible is paid to him and if the Commissioner finds that such party is lawfully entitled thereto or to any part thereof, he shall pay the same to such party as provided for refunds by G.S. 105-407 and if such payment is denied, said party may appeal from the determination of the

Commissioner to the Superior Court of Wake County or to the superior court of the county wherein he resides or does business. The intangibles of a taxpayer shall be paid or collected hereunder only to the extent necessary to satisfy said taxes, interest, penalties, and costs. Except as hereinafter set forth, the remedy provided in this section shall not be resorted to unless a warrant for collection or execution against the taxpayer has been returned unsatisfied: Provided, however, if the Commissioner is of opinion that the only effective remedy is that herein provided, it shall not be necessary that a warrant for collection or execution shall be first returned unsatisfied, and in no case shall it be a defense to the remedy herein provided that a warrant for collection or execution has not been first returned unsatisfied: Provided, however, that no salary or wage at the rate of less than two hundred dollars ($200.00) per month, whether paid weekly or monthly, shall be attached or garnished under the provisions of this section."

SECTION 10. This act becomes effective January 1, 2008, and applies to taxes paid on or after that date.

BILL DRAFT 2007-SVz-2A: Uniform Tax Refund Procedure

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 22, 2007
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft 2007-SVz-2A]		Committee Counsel

SUMMARY: This proposal does three things:

- ***Consolidates the tax refund process into a single, uniform procedure regardless of the nature of the refund request.***
- ***Changes the statute of limitations period for filing (1) a demand for refund, and (2) a civil action after the denial of a refund claim.***
- ***Limits class actions for tax refunds to only those taxpayers who have filed a written demand for a refund.***

CURRENT LAW: The procedure for obtaining a refund of tax paid by a taxpayer depends on the nature of the claim. If the taxpayer is challenging the constitutionality of a tax, then the taxpayer must follow the procedure set out in G.S. 105-267, known as the "payment under protest rule." If the taxpayer claims that the tax paid was incorrect or excessive, then G.S. 105-266.1 governs the refund procedure. Under both statutes, the taxpayer is required to apply to the Secretary in writing for a refund. Under G.S. 105-267, the refund request must be made within three years after payment.[1] Under G.S. 105-266.1, the refund request must be made within three years after the date for filing of the return or within 6 months after payment of the tax, whichever is later.[2] At this stage, the procedure varies as follows:

Payment under protest (G.S. 105-267). **–** Once the refund request has been made, the Secretary has 90 days to issue a decision and refund the tax in accordance with the decision. If the tax is not refunded within 90 days, the taxpayer may file a civil action at any time within three years after the expiration of the 90-day period allowed for making the refund. Thus, a taxpayer potentially has a maximum of 6 years and 90 days to bring a civil action. If upon trial it is determined that all or part of the tax was levied for an "illegal or unauthorized purpose," judgment shall be rendered for the taxpayer, and the amount of the judgment must be refunded by the State.

Refunds for overpayment (G.S. 105-266.1). **–** Once the refund request has been made, the Secretary reviews the request and notifies the taxpayer of the decision. If the refund is reduced or disallowed, the taxpayer may request a hearing. The Department will schedule a hearing within 90 days, unless the taxpayer and the Secretary agree to a later date. Within 90 days of the hearing, the Secretary must make a decision, notify the taxpayer, and adjust the tax in accordance with the decision. A taxpayer aggrieved by the Secretary's decision may, within 90 days after notification of the decision, either:

[1] The protest period for taxes paid on alcoholic beverages, tobacco products, and controlled substances is 30 days after payment.

[2] The statute of limitations period varies for overpayments associated with worthless debts or securities, capital losses and net operating losses, and returns reflecting a federal determination.

1. Petition for administrative review before the Tax Review Board under G.S. 105-241.2[3]; or
2. Bring a civil action against the Secretary for recovery of the alleged overpayment.[4]

BILL ANALYSIS:

Single, Uniform Procedure

The proposal repeals G.S. 105-266 and G.S. 105-266.1 and creates a new statutory section governing refund claims without making any distinction based on the type of claim. G.S. 105-267 is also substantially amended. Only the first two sentences are maintained, with minor changes, in order to preserve the prohibition on actions brought to enjoin the collection of a tax and the body of case law upholding the constitutionality of the requirement that a taxpayer pay the tax prior to challenging its legality in court.

Under this proposal, refund claims for overpayments and refund claims for "payments under protest" would be subject to the same procedural requirements. If a taxpayer claims to have overpaid a tax, whether the claim is that the tax is incorrect or that the statute imposing the tax is unconstitutional, the taxpayer must file a demand with the Secretary within the prescribed time period. The Secretary must grant or deny the demand within six months from the date the demand is filed and notify the taxpayer of the decision. If the Secretary fails to grant a refund within the six-month period, the demand for a refund is deemed denied. Within 30 days of notice of the denial, the taxpayer may request a hearing before the Secretary. An additional 30 days is provided if the demand is "deemed denied." The hearing must take place within 90 days of the filing of the request for a hearing. The Secretary must issue a decision within 90 days of the hearing. Instead of requesting a hearing, a taxpayer may bring a civil action in superior court within 90 days of the denial of a refund demand.

This proposal represents the first step in an attempt to simplify the current refund procedure, which is controlled by statutes that are unclear and that have been significantly muddied by recent North Carolina court decisions. The Committee has also spent a great deal of time this interim studying the tax appeals process, but to date, has not reached a consensus. While the refund process and the appeals process necessarily overlap, the issues are distinct. With regard to refunds, one issue is whether these claims should follow the same procedural path regardless of the nature of the claim. With regard to appeals, one of the issues is to what forum that path leads. The specifics of this proposal may evolve depending on the Committee's recommendation with regard to tax appeals, but one of the principles for which the Committee has expressed support is that the refund process should be consolidated into a single, uniform procedure; this proposal reflects that principle.

Statute of Limitations

Under federal law, a refund claim must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever is later, or if no return was filed by the taxpayer, within two years from the time the tax was paid. The statute of limitation under federal law for filing a civil action is two years from the notice of disallowance of the refund.

In North Carolina, there are two different sets of statutes of limitation, as set out in the table below, because North Carolina has two different refund procedures. In order to establish a single, uniform refund procedure, the statutes of limitation should be the same. The draft proposal changes the statutes of limitation for protest claims to match the current statutes of limitation for overpayment claims.

[3] Either party may appeal a decision of the Tax Review Board to superior court, then to the North Carolina Court of Appeals, and then to the North Carolina Supreme Court.
[4] Either party may appeal to the appellate division from the judgment of the superior court.

	Overpayments (Current Law)	Payments Under Protest (Current Law)	All Refund Claims (Draft Proposal)
For demanding a refund	**3 years after date for filing return, or 6 months after payment of tax, whichever is later**	**3 years after payment of tax**	**3 years after date for filing return, or 6 months after payment of tax, whichever is later**
For bringing a civil action after denial of a refund claim	**90 days after notification of Secretary's decision**	**3 years after expiration of 90-day period**	**90 days after denial of refund by Secretary.**

When the Committee first considered this proposal, it endorsed as one of its guiding principles the notion that the refund process should protect the fiscal stability of the State. The protest statute in its current form and recent judicial interpretation appear to be moving away from the original intent of the statute, which was to provide meaningful notice to the State of anticipated refunds so that the State may budget accordingly. The shorter the statute of limitations period, the sooner the State is put on notice of a challenge. The longer the statute of limitations, the longer the State continues to levy a potentially unconstitutional tax. The original statute of limitations for filing a civil action was 30 days. Now, with the current period for demanding a refund, a taxpayer potentially has 6 years and 90 days to challenge a tax. This draft shortens the statute of limitations, which is consistent with the original intent of the statute and is designed to protect the fiscal stability of the State.

Class Actions

The proposal would also require that every member of a class action file a written demand for a refund prior to bringing suit.

This limitation is in response to recent court decisions that have significantly undercut the protest requirement in G.S. 105-267. In *Bailey II*, the Court said that the requirement of filing a written demand prior to filing suit was only required to the extent the State has notice of its potential fiscal liability. The *Dunn* Court went even further stating that as long as the State had notice that a tax was being challenged, the requirement was met and the burden was on the State to figure out its potential liability. Under *Dunn*, the protest requirement, which was originally intended to provide the State with notice, becomes meaningless because it is only after a court determines who should make up the class that the State can begin to determine its potential liability, and class certification may occur years after the payment of the tax.

This draft proposal clarifies the original intent of the protest statute which is that every taxpayer seeking a refund must first file a written demand, including members of a class action. Notably, class actions are prohibited in United States Tax Court and class action refund suits in other federal courts require that every member of the class file a written demand.

ISSUES FOR CONSIDERATION: The issue of remedying unconstitutional taxes is an extremely complex one. Among the states, there is a variety of different results with little to no consistent analysis. This draft proposal represents a first step toward providing clarity in the law, but at this stage, it does not represent input from interested parties, such as the Department of Revenue or the Tax Council of the Bar Association. Many issues may need further development such as the form and content of a demand for a refund, whether the time periods are appropriate, whether the monetary threshold for venue purposes should be updated, and most importantly, the effect of a class action. Should the Committee decide that every person seeking a refund must file a demand, including all members of a class action, then the statute should indicate whether the filing of a class action tolls the period to file a demand and for how long. Should the Committee decide that not all persons seeking a refund of an unconstitutional tax must file a demand, then the statute should provide some guidance in that regard as well.

EFFECTIVE DATE: The act would become effective January 1, 2008, and apply to taxes paid on or after that date.

2007-SVz-2A-SMSV

LEGISLATIVE PROPOSAL #3

IRC UPDATE

LEGISLATIVE PROPOSAL #3

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

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

SHORT TITLE: IRC Update.

SPONSORS:

BRIEF OVERVIEW: This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions.

FISCA L IMPACT: The adoption of the proposal would result in a General Fund revenue loss of $58.0 million for 2007-08 and $46.6 million for 2008-09. In future years the loss would decline and there would be an annual revenue gain starting in 2010-11. Almost all of the impact of the bill can be counted as non-recurring. The table on the following page shows the impact of each item in the package.

EFFECTIVE DATE: This act would become effective when it becomes law.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2007

U **D**

BILL DRAFT 2007-SVxz-1 [v.5] (12/06)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/12/2007 11:28:09 AM

Short Title: IRC Update.	**(Public)**
Sponsors: Unknown.	
Referred to:	

A BILL TO BE ENTITLED

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

The General Assembly of North Carolina enacts:

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

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

…

(1b) Code. – The Internal Revenue Code as enacted as of ~~January 1, 2006,~~ January 1, 2007, including any provisions enacted as of that date which become effective either before or after that date.

SECTION 2. Notwithstanding Section 1 of this bill, any amendments to the Internal Revenue Code enacted after January 1, 2006 that increase North Carolina taxable income for the 2006 taxable year become effective for taxable years beginning on or after January 1, 2007.

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

BILL ANALYSIS

2007-SVxz-1: IRC Update

Committee:	Revenue Laws Study Committee	**Date:**	January 12, 2007
Introduced by:		**Summary by:**	Heather Fennell
Version:	Draft 2007-SVxz-1		Committee Counsel

SUMMARY: This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions.

CURRENT LAW: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[1] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[2] Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law tracks federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made.

BILL ANALYSIS:

IRC UPDATE

This bill would change the reference date to January 1, 2007, effective when the bill becomes law. Changing the reference date to January 1, 2007 would incorporate the changes made in the following acts: the Deficit Reduction Act of 2005, the Tax Increase Prevention and Reconciliation act of 2005, the Heroes Earned Retirement Opportunities Act, the Pension Protection Act of 2006, and the Tax Relief and Health Care Act of 2006.

Between January 1, 2006 and December 20, 2006 there were five major pieces of federal legislation that made changes to the Internal Revenue Code. This federal legislation includes the Deficit Reduction Act of 2005 (P.L. 109-71) signed into law February 9, 2006, the Tax Increase Prevention and Reconciliation act of 2005 (P.L. 109-222) signed into law May 18, 2006, the Heroes Earned Retirement Opportunities Act (P.L. 109-227) signed into law May 23, 2006, the Pension Protection Act of 2006 (P.L. 109-280) signed into law August 19, 2006 and the Tax Relief and Health Care Act of 2006 (P.L. 109-432) signed into law December 20, 2006.

[1] North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

[2] 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."

Deficit Reduction Act of 2005 (P.L. 109-171)

Although this act makes numerous tax changes at the federal level, these changes have little to no direct impact at the state level.

Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222)

- *Amortization treatment of musical compositions.* Under current law, taxpayers are allowed to recover, through annual depreciation deductions, the costs of certain property used in a trade or business or for the production of income. The costs associated with the creation or acquisition of musical compositions may be depreciated using the income forecast method. Under this method, the depreciation is determined by multiplying the adjusted basis for the property by the proportion the income generated by the property during the tax year to the total forecasted income for the property for ten years. A "look-back" method is used to recapture any underpayment created by forecasting. In the third and tenth year, actual income of the property is used to determine what the taxpayer's deduction should have been if the forecast method was not used. If the forecasted income is within 10 percent of the estimated income in these years, the "look-back" method does not need to be applied.

  Under the act, expenses incurred for the creation or acquisition of musical compositions may be amortized over five years. Taxpayers can elect to amortize these expenses or use the previous forecast method. This provision applies to tax years beginning after December 31, 2005 and before January 1, 2011.

- *Amortization treatment of G & G expenditures.* The geological and geophysical (G &G) costs incurred for the purpose of accumulating data to serve as the basis for the decision about acquisition or retention of mineral rights by taxpayers in the business of exploring for minerals (including gas and oil) were previously considered capital expenditures and allocated to the property (or properties) purchased as a result of this data. If no property was purchased, these costs were taken as a loss in the year the project was abandoned. Last year, the Energy Tax Incentive Act of 2005 allowed these expenses to be amortized over two years.

  The act allows for these costs to be amortized over five years for large integrated oil companies. Large integrated oil companies are defined as companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and an ownership interest in a crude oil refiner of 15 percent or more. This provision is effective for tax years beginning after August 8, 2005.

- *Extension of taxation of passive income of minors.* Special rules apply to the unearned income of a child who is under age 14. The special tax, colloquially called the "kiddie tax," is applied if: 1) the child has not reached the age of 14 by the close of the taxable year; 2) the child's unearned income was more than $1,700; 3) the child is required to file a return for the year. The tax applies regardless of whether the child may be claimed as a dependent on the parent's return. For children under age 14, unearned income is taxed at the parent's rate if the parent's rate is higher than the child's rate. The remainder of a child's taxable income is taxed at the child's rates, regardless of whether the tax applies to the child.

  The act expands the rule to include all minors under the age 18 in the "kiddie tax." There is an exception for distributions from certain qualified disability trusts. The minor child tax does not apply to a child that is married and files a joint tax return. This provision applies to taxable years beginning after December 31, 2005.

- *Increased expensing for small businesses.* Prior to the *American Jobs Creation Act of 2004*, small businesses were eligible to expense up to $25,000 of the cost of qualifying property placed in service for the taxable year. Qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $25,000 amount was reduced dollar-for-dollar by the amount by which the cost of the qualifying property exceeded $200,000. The deduction was increased to $100,000, with costs exceeding $400,000 reducing the deduction by the *American Jobs Creation Act of 2004.* This provision was set to expire for tax years beginning after December 31, 2006.

  This act extends the enhanced small business expensing thresholds until tax years beginning after 2007 and before 2010.

- *Increased income limit for conversion of traditional IRAs to Roth IRAs.* There are two general types of individual retirement arrangements (IRAs): traditional IRAs and Roth IRAs. The total amount an individual may contribute is limited to the lesser of a dollar amount ($4,000 for 2006), or the amount of the individual's taxable income for the year. Contributions to a traditional IRA are generally deductible. Distributions from a traditional IRA are included in gross income to the extent the distributions are not attributable to a return of nondeductible contributions. Contributions to a Roth IRA are not deductible. Distributions from a Roth IRA are excludable from gross income. A taxpayer with an adjusted gross income of $100,000 or less may convert all or a portion of a traditional IRA to a Roth IRA. Married taxpayers filing separate returns may not convert a traditional IRA into a Roth IRA.

  This act eliminates the income limits on conversions of traditional IRAs to Roth IRAs. The amount converted is treated as taxable income in the year it is converted; however, taxpayers who convert in 2010 and do not take distributions from the converted plan until after 2012, have the option of either recognizing all of the income in 2011 or including the income ratably over the tax years 2011 and 2012. This provision is effective for tax years beginning after December 31, 2009.

Heroes Earned Retirement Opportunities Act (P.L. 109-227)

The sole purpose of this act is to allow members of the Armed Forces serving in a combat zone to make contributions to retirement plans. Contributions to individual retirement plans are limited to the lesser of $4,000 or the individual's taxable income. Combat pay is not considered taxable income; therefore, many members of the Armed Forces are currently unable to make retirement contributions. This provision will treat combat pay as taxable income for the purposes of making contributions to an individual retirement account. This provision is retroactive to tax years beginning after December 31, 2003. This act will lower Federal and state taxable income and can result in amended returns for earlier years.

Pension Protection Act of 2006 (P.L. 109-280)

Contributions and Benefits

- *Increase in employer deduction limitations for contribution to defined benefit plans.* An employer's contributions to a qualified retirement plan are generally deductible, but the amount that qualifies for the deduction is limited. Under the level funding method, the limitation on the amount of deductible contributions is the amount necessary to provide the remaining unfunded cost of the participant's past and current service credits distributed as a level amount of the remaining future service of each participant. Under the normal cost method, the limitation on the amount of deductible contributions is the amount equal to the normal cost of the plan, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount necessary to amortize the unfunded costs attributable to such credits in equal annual payments over ten years. Regardless of the type of defined benefit plan, the maximum limitation for contribution deductions cannot be any less than the unfunded current liability.

The act increases the deduction limits for contributions to defined benefit plans with different limits placed upon single-employer plans, multi-employer plans, and combined plans.

> Single-employer plans: For years beginning in 2006 and 2007, the maximum deduction limitation cannot be less than the unfunded current liability. However, when calculating unfunded current liability a single-employer plan subtracts the value of the plan's assets from 150 percent of the current liability of the plan. In years beginning after December 31, 2007 the annual deduction limitation is the greater of 1) the minimum contribution or 2) the excess of the sum of: (i) the funding target for the plan year, (ii) the target normal cost for the plan year, the "cushion amount" for the plan year; over the value of the assets held in the plan. For plans that are not "at risk," the cushion amount is removed from the computation in (ii). The "cushion amount" is generally the sum of 50 percent of the funding target for the plan year and the amount by which the funding target would increase for the year if the plan took into account expected future increases in compensation or, if the plan does not base benefits for past service on compensation, expected increases in benefits in succeeding plan years.
>
> Multi-employer plans: For years beginning in 2006 and 2007, the maximum amount of the deduction limitation for contributions to multi-employer plans cannot be less than 140 percent of the current liability of the plan minus the plan's assets. For years beginning after December 31, 2007, the formula for the deduction is the same, but benefits that are non-forfeitable under the plan after termination of the plan should not be taken into account in computing the current liability of the plan.
>
> Combined plans: The deduction limit for combined plans only applies to contributions that exceed six percent of the compensation otherwise paid or accrued to the beneficiaries under the plan year.

- *Increased IRA contributions for individuals affected by employer's bankruptcy.* Both traditional and Roth IRAs are subject to annual contribution limits. For 2006 the annual limit is the lesser of $4,000 or the individual's taxable income. Individuals who have reached the age of 50 are allowed to make annual "catch-up" contributions. The annual limit on "catch-up" contributions is $1,000.

The act provides employees affected by an employer's bankruptcy the option to make additional contributions to an IRA. For the years 2007 – 2009, increased contributions up to an additional $3,000 per year over the yearly contribution limit are allowed for individuals affected by an employer's bankruptcy. All of the following requirements must be met:

> 1) the employee must have participated in the employer's 401(k) plan on the date six months preceding the employer filing for bankruptcy,

2) the employer matched at least 50 percent of the employee's contribution with employer stock,
3) the employer is a debtor in bankruptcy in a preceding tax year,
4) the employer or any other person must have been subject to an indictment or conviction in a preceding tax year resulting from business transactions related to the bankruptcy case.

Health and Medical Benefits

- *Health insurance premiums for retired public safety officers.* Distributions from a qualified retirement plan are generally included in taxable income the year of the distribution except to the extent attributable to after-tax contributions.

  Retired public safety officers may exclude from taxable income up to $3,000 of otherwise taxable distributions from a government pension if used to pay for health insurance premiums. The individual must have separated from service either due to disability or by reaching normal retirement age. The term "public safety officer" is defined using the *Omnibus Crime Control and Safe Street Act of 1986* definition rather than the definition of public safety officer used in other provisions of the PPA. [3] This provision is effective for tax years beginning after December 31, 2006.

Plan Distributions and Rollovers

- *Modification of hardship and unforeseen financial emergency rules.* Currently, early distributions from 401(k) plans, tax sheltered annuities, 457 plans or nonqualified deferred compensation plans are allowed for hardship and unforeseen financial emergencies of the individual plan participant, or the individual's spouse or dependent.

  The act directs the Secretary of Treasury to modify regulations for determining whether a participant has had a hardship or unforeseen financial emergencies for purposes of receiving an early distribution from a qualified retirement plan. The new regulations must provide that a hardship or unforeseen financial emergency of any beneficiary of a plan participant, regardless of the beneficiary's relationship to the plan participant, qualifies for an early distribution. This provision is considered effective after August 17, 2006.

- *Treatment of certain distributions to public safety employees.* Unless an exception to the penalty applies, distributions from a qualified retirement plan prior to age 59 ½, death or disability of a plan participant, are subject to a 10% early withdrawal penalty.

  Under this act, the early withdrawal penalty will not apply to distributions from a government plan to a qualified public safety employee who separates from service after the age of 50. A qualified public safety employee is "any employee of a State or political subdivision of a State who provides police protection, fire-fighting services, or emergency medical services for any area within the jurisdiction of the state or political subdivision." This provision is considered effective after August 17, 2006.

[3] Under the Omnibus Crime Control Act a "public safety officer" includes an individuals who 1) are involved in crime control or reduction, or enforcement of criminal laws, including but not limited to police, corrections, probation, parole and judicial officers; 2) professional firefighters; 3) officially recognized or designated public employee members of a rescue squad or ambulance crew; 4) officially recognized or designated members of a legally organized volunteer fire department; and 5) officially recognized or designated chaplains of volunteer fire departments, fire departments, and police departments.

- *Treatment of distributions to individuals called to active duty in excess of 179 Days.* Unless an exception to the penalty applies, distributions from a qualified retirement plan prior to age 59 ½, death or disability of a plan participant, are subject to a 10% early withdrawal penalty.

Under this act, the early withdrawal penalty will not apply to distributions to a qualified reservist if the reservist or national guardsman is ordered or called to duty for a period in *excess* of 179 days or for an indefinite period.[4] To qualify for the exception to the penalty, the distribution must be made during the period from when the reservist was called to duty and the close of active duty. The individual may repay the amount withdrawn up to two years after the end of active duty. Limitations on IRA contributions are lifted for this two year period of repayment, but no deductions can be taken for contributions made for repayment purposes. This provision applies to distributions made after September 11, 2001.

- *Direct rollovers from eligible retirement plans to Roth IRAs.* Previously, distributions from tax-qualified retirement plans, tax-sheltered annuities and section 457 plans could be not be directly rolled into a Roth IRA. These distributions could only be rolled into a Roth IRA by first rolling the distributions into a traditional IRA and then into a Roth IRA provided the individual met the additional limitations on rolling over a traditional IRA into a Roth IRA.

The act provides that starting in January 2008, distributions from tax-qualified retirement plans, tax-sheltered annuities and section 457 plans can be rolled directly into a Roth IRA. For tax years prior to January 1, 2010, taxpayers with adjusted gross income less than $100,000 and either single or married filing jointly are allowed to rollover a traditional IRA to a Roth IRA. For later tax years, the income limit is eliminated (see *Tax Increase Prevention and Reconciliation Act of 2005*). This provision applies to distributions after December 31, 2007.

- *Rollovers by nonspouse beneficiaries.* Generally, distributions from tax-qualified retirement plans, tax-sheltered annuities and section 457 plans are taxed in the year distributed. Certain eligible distributions can be rolled over to eligible retirement plans, tax free, within 60 days of the distribution. A surviving spouse beneficiary of a plan participant can roll over distributions from the decedent's plan as if the surviving spouse were the original plan participant.

This act provides that nonspouse beneficiaries can now rollover the distributions of a decedent's eligible retirement plan tax-free into an IRA via a trustee-to-trustee transfers. However, the new IRA is treated as an inherited account (no further rollovers allowed), and required minimum distribution rules apply. This provision is effective for distributions after December 31, 2006.

Charitable Contributions

- *Tax-free IRA distributions to charities.* Generally, to make a charitable donation from an IRA, a distribution must be taken and the applicable rules regarding taxable income apply. The distribution is included in taxable income to the extent the distributions are not attributable to a return of nondeductible contributions. The standard charitable deduction rules then apply to the donation.

This act provides that individuals 70 ½ or older can now distribute up to $100,000 per taxable year from their IRAs to charitable institutions without recognizing the income. The distribution must be made directly to the charitable organization from the trustee. This distribution counts

[4] "Short tour opportunities" defined by military guidelines are 179 days *or less*.

towards the required minimum distribution. The provision is effective for distributions made after December 31, 2005 and before January 1, 2008.

- *Charitable contributions of clothing and household items.* The charitable deduction of noncash property is generally the property's fair market value. For contributed items used in a manner unrelated to the donee's exempt purpose, the deduction is generally the donor's basis in the item. For donations of clothing and household items with a value of less than the original basis, most taxpayers deduct the fair market value of the item.

The act provides that contributions of clothing or household goods are limited to items that are in "good" used conditions or better unless the deduction for a single item exceeds $500 and the taxpayer includes a qualified appraisal. This provision applies to contributions made after August 17, 2006.

- *Charitable Contributions of Taxidermy Property*. The charitable deduction of noncash property is generally the property's fair market value. For contributed items used in a manner unrelated to the donee's exempt purpose, the deduction is generally the donor's basis in the item.

The act provides that the charitable deduction allowed for contributions of taxidermy property is the lesser of either the donor's basis in the property, or the fair market value of the property. In determining the donor's basis in the property, only direct costs paid or incurred by the donor for preparing, stuffing, or mounting the property are included.

- *Real property contributions for conservation.* The deduction for capital gain appreciated real property is generally limited to 30 percent of the donor's adjusted gross income if the donor uses the fair market value of the donated property. If the donor's basis is used as the value of the property, and the property is donated to a "maximum deduction" organization, the deduction is limited to 50 percent of the donor's adjusted gross income.[5] Deductions for donations to non-maximum donation organizations are limited to 20 percent of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years.

The act changes the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50 percent of adjusted gross income, with a 15-year carryforward for any excess. A "qualified farmer or rancher" may deduct the value of the gift up to 100 percent of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming is greater than 50 percent of the taxpayer's gross income for the tax year. The land donated by a farmer or rancher also must "be available" for agricultural use, but it need not be used for that purpose. This provision applies to contributions made in tax years beginning after December 31, 2006.

- *Charitable contributions of façade easements.* A façade easement is a real property contribution for conservation that can be used to preserve the architectural, historic and cultural features of the façade of a building. Homes listed in either the National Register of Historic Places or located in a historic district and certified by the National Park Service as being of historical significance to the district qualify for this treatment.

[5] Maximum deduction organizations include public charities, private operating foundations, private non-operating foundations that distribute contributions within two and one-half months of the year's end, and private non-operating foundations that maintain a common fund.

The act allows for deductions for charitable contributions of façade easements of private residences only if the residence is listed individually in the National Register of Historic Places. For properties that are located in a historic district and certified by the National Park Service as being of historical significance to the district, the charitable deduction is allowed only if the restrictions relate to the entire exterior of the building, including the space above the building, the sides, the rear and the front of the building. The deduction for all properties is reduced to take account any rehabilitation credit previously claimed. The deduction for the façade easement is reduced by the percentage the rehabilitation credit represents of the fair market value of the home. This provision applies to contributions made after August 17, 2006.

- *Charitable deduction for contribution of food inventories.* A taxpayer's deduction for charitable contributions of inventory is generally limited to the lesser of the taxpayer's basis in the inventory (usually cost) or the fair market value of the inventory. For certain contributions of inventory, a C corporation may claim an enhanced deduction equal to the lesser of 1) basis plus one-half on the item's appreciation or 2) two times basis. To be eligible for the enhanced deduction, the contributed property must generally be inventory of the corporation, contributed to a charitable organization described in section 501(c)(3) of the Code, and the donee must 1) use the property consistent with the donee's exempt purpose only for the care of the ill, the needy, or infants, 2) not transfer the property in exchange for money, other property, or services, and 3) provide the taxpayer with a written statement attesting to the proper use of the property.

This act allows the enhanced deduction to any taxpayer engaged in a trade or business that makes a donation of food inventory. For taxpayers other than C corporations, the total deduction for contributions of food inventory may not exceed 10% of the taxpayer's income from all business entities from which a contribution of food inventory is made. The enhanced deduction is available only for food that qualifies as "apparently wholesome food," – food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws even though the food may not be readily marketable for any number of reasons. The act extends for two additional years the enhanced deduction for the charitable deduction for contribution of food inventories. This provision is now set to expire for contributions made after December 31, 2007.

- *Charitable deduction for contribution of book inventories.* A taxpayer's deduction for charitable contributions of inventory is generally limited to the lesser of the taxpayer's basis in the inventory (usually cost) or the fair market value of the inventory. For certain contributions of inventory, a C corporation may claim an enhanced deduction equal to the lesser of 1) basis plus one-half on the item's appreciation or 2) two times basis. To be eligible for the enhanced deduction, the contributed property must generally be inventory of the corporation, contributed to a charitable organization described in section 501(c)(3) of the Code, and the donee must 1) use the property consistent with the donee's exempt purpose only for the care of the ill, the needy, or infants, 2) not transfer the property in exchange for money, other property, or services, and 3) provide the taxpayer with a written statement attesting to the proper use of the property.

This act extends the enhanced deduction for C corporations to qualified book contributions. A "qualified book contribution" is a charitable contribution of books to a public school that provides elementary education or secondary education and that is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils in attendance at the place where its education activities are regularly carried on. The act extends for two additional years the enhanced deduction for the charitable deduction for contribution of book inventories. This provision is now set to expire for contributions made after December 31, 2007

Tax Relief and Health Care Act of 2006 (P.L. 109-432)

Extension of prior provisions:

This act extends for two years, until the tax year ending December 31, 2007, the following provisions:

- *Above the line deduction for higher education expenses.* Under prior law, individuals were allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year. The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). This deduction was available for tax years beginning prior to December 31, 2005.

  This provision is extended for two years, until the tax year ending December 31, 2007.

- *Deduction of state and local general sales taxes.* The American Jobs Creation Act (ACJA) of 2004 allowed taxpayers to deduct state and local sales taxes in lieu of deducting state and local income taxes, real property taxes, and personal property taxes. This provision became effective with the 2004 taxable year and was set to expire for tax years beginning in 2006 and thereafter. This provision extends the deduction for two years, through December 31, 2007.

  The General Assembly did not conform to this change under the ACJA. In order to allow this deduction for North Carolina income tax purposes, affirmative action must be taken to conform to the initial change as well as the extension of the provision as provided in this act. The current bill takes no action on this matter.

- *Above the line deduction for qualified expenses of elementary and secondary school teachers*. Under prior law, an eligible educator was allowed an above-the-line deduction of up to $250 for amounts paid by the teacher for books or supplies used in the class room. An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during the school year. This deduction was available for tax years beginning prior to December 31, 2005.

  This provision is extended for two years, until the tax year ending December 31, 2007.

- *Fifteen-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant property.* Prior law provided for 15-year straight-line depreciation for qualified leasehold improvements to nonresidential real property placed into service after the date of enactment (October 22, 2004) and prior to January 1, 2006. A qualified leasehold improvement is an improvement made to the interior of a building by either the lessor or lessee and placed in service more than three years after the building is placed in service. Under prior law, a qualified leasehold improvement was depreciated using straight-line depreciation over a 39-year period – the same period as for depreciation of nonresidential property in general.

  A similar depreciation schedule is put into place for qualified restaurant property placed into service after the date of enactment (October 22, 2004) and prior to January 1, 2006. In order to qualify as "qualified restaurant property," the property must be a building improvement placed in service more than three years after the building is placed in service and the restaurant must use more than half of the square footage of the building. This deduction was available for tax years beginning prior to December 31, 2005.

This provision is extended for two years, until the tax year ending December 31, 2007.

- *Enhanced deduction for the charitable donation of computer technology and equipment.* Prior law allowed an enhanced deduction for contributions of computer technology or equipment to schools or public libraries that would use the computer equipment for educational purposes. This deduction was available for tax years beginning prior to December 31, 2005.

This provision is extended for two years, until the tax year ending December 31, 2007.

This act extends for one year, until the tax years ending December 31, 2009, the following provision:

- *Deduction for energy efficient commercial buildings.* Prior law allowed a deduction for energy efficient commercial buildings. Energy efficient expenditures are certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, and ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building. The deduction is limited to $1.80 per square foot of property for which such expenditures are made. A partial allowance of the deduction is allowed for buildings that do not meet the requirement of a 50 percent energy savings but are certified by a qualified profession as meeting or exceeding the applicable system specific savings targets established by the Secretary of the Treasury. This deduction is available for property placed in service after December 31, 2005 and prior to January 1, 2008.

This provision extends the deduction to property placed in service prior to January 1, 2009.

New provisions:

- *Change in contribution limitations for Health Savings Accounts*. Under current law individuals with a high deductible health plan may establish health savings accounts ("HSA") for the payment of current and future medical costs. Contributions to HSAs made by or on behalf of an individual are deductible by the individual. The contributions are limited to the lesser of (1) the annual deductible of the health plan or (2) $2,850 for individual coverage and $5,650 for family coverage.

The act modifies the contribution limitation for HSAs. Contributions are now limited to $2,850 for individual coverage and $5,650 for family coverage. This provision is effective for taxable years beginning after December 31, 2006.

- *Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico.* Present law provides a deduction from taxable income that is equal to a portion of the taxpayer's qualified production activities income in the United States. For the taxable year beginning in 2006 the deduction is three percent of income. For the taxable year beginning in 2007 the deduction is six percent of income. Currently, Puerto Rico is not in the definition of the United States.

The act includes Puerto Rico in the definition of the United States for the purposes of determining domestic production activities, but only if all of the taxpayer's gross receipts from sources within Puerto Rico are currently taxable for U.S. Federal Income tax purposes. This provision is effective for the first two taxable years beginning after December 31, 2005, and before January 1, 2008.

• *Deduction for premiums for mortgage insurance.* Present law provides for a deduction for qualified residence interest. The maximum amount of home equity indebtedness is $100,000. The maximum amount or acquisition indebtedness is $1 million. The act provides that premiums paid for mortgage insurance on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The amount allowable as a deduction under the provision is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000 respectively, in the case of a married individual filing a separate return). The deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of a married individual filing a separate return).

This provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007. The provision terminates for any amount paid or accrued after December 21, 2007, or property allocable to any period after that date.

H0050e3-SMTD

INTERNAL REVENUE CODE UPDATE
ESTIMATED GENERAL FUND REVENUE IMPACT ($MILL)

Provision	Recurring?	2006-07	2007-08	2008-09	2009-10	2010-11
Tax Increase Prevention and Reconciliation Act						
Extension of taxation of passive income minors	Yes	1.7	1.7	1.8	1.8	1.9
Increased expensing for small businesses	No	0.0	-35.8	-27.9	-8.5	11.4
Increased income limit for conversion of traditional IRA's to Roth IRA's	Yes	0.0	0.0	-1.3	-2.5	-21.9
Pension Protection Act 2006						
IRA inflation indexing	Yes	0.0	0.0	-0.4	-0.8	-0.9
Health Insurance premiums for retired public safety officers	Yes	0.0	-2.0	-2.2	-2.5	-2.8
Tax free IRA distributions to charities	No	0.0	-1.8	-0.8	-.2	0.0
Charitable deductions for contribution of food inventories	No	-0.6	-0.9	-0.7	0.0	0.0
Tax Relief and Health Care Act of 2006						
Deduction for higher education tuition, etc.	No	0.0	-13.9	-14.4	0.0	0.0
Deductions for qualified expenses of K-12 teachers	No	0.0	-2.3	-1.3	0.0	0.0
Depreciation for qualified leasehold improvements and qualified restaurant property	No	-1.0	-1.3	-1.5	-1.5	-1.4
Deduction for the donation of computer technology and equipment	No	-0.4	-0.2	0.0	0.0	0.0
Deduction for energy efficient commercial buildings	No	0.0	0.0	0.0	0.0	0.0
Change in contribution limitations for Health Savings Accounts	Yes	-0.5	-0.4	-0.4	-0.4	-0.4
Total Impact		**-$0.8**	**-$56.9**	**-$49.1**	**-$14.4**	**-$14.1**
Recurring		**1.2**	**-0.7**	**-2.5**	**-4.4**	**-24.1**
One-Time		**-$2.0**	**-$56.2**	**-$46.6**	**-$10.0**	**$10.0**

LEGISLATIVE PROPOSAL #4

CONSERVATION TAX CREDIT MODIFICATIONS

LEGISLATIVE PROPOSAL #4

A RECOMMENDATION OF THE REVENUE AWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO MODIFY THE CREDIT FOR CERTAIN REAL PROPERTY DONATIONS.

SHORT TITLE: Conservation Tax Credit Modifications.

SPONSORS:

BRIEF OVERVIEW This proposal would equalize the cap for the conservation tax credit for corporations and pass-through entities at $500,000. The proposal would also require any taxpayer claiming the credit to support the claim's represented value of the real property donation by using either certain appraisal reports or the county's appraisal value as adjusted by the sales assessment ratio. Finally, the proposal narrows the conservation purposes which qualify the land for a credit.

FISCAL IMPACT: No fiscal estimate available at publication. Based on discussions with the Department of Revenue, there is not sufficient data available for an accurate assessment of the fiscal impact from the proposed changes in the bill. Without sufficiently detailed date, it is not possible to measure the impact the modifications in the bill will have on the conservation tax credit.

EFFECTIVE DATE: This bill would become effective for taxable years beginning on or after January 1, 2007.

A copy of the proposed legislation and a bill analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

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BILL DRAFT 2007-MCxz-17 [v.4] (1/8)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/12/2007 4:47:38 PM

Short Title:	**Conservation Tax Credit Modifications.**	**(Public)**
Sponsors:	**.**	
Referred to:		

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE CREDIT FOR CERTAIN REAL PROPERTY DONATIONS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-130.34 reads as rewritten:

"**§ 105-130.34. Credit for certain real property donations.**

(a) Any corporation that makes a qualified donation of an interest in real property located in North Carolina during the taxable year that is useful for (i) public beach access or use, (ii) public access to public waters or trails, (iii) fish and wildlife conservation, ~~or other similar land conservation purposes~~ (iv) forestland or farmland conservation, (v) watershed protection, (vi) conservation of natural areas as that term is defined in G.S. 113A-164.3(3), (vii) conservation of natural or scenic river areas as those terms are used in G.S. 113A-34, (viii) conservation of predominantly natural parkland, or (ix) historic landscape conservation is allowed a credit against the tax imposed by this Part equal to twenty-five percent (25%) of the fair market value of the donated property interest. To be eligible for this credit, the interest in real property must be donated in perpetuity to and accepted by the State, a local government, or a body that is both organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions pursuant to G.S. 105-130.9. Lands required to be dedicated pursuant to local governmental regulation or ordinance and dedications made to increase building density levels permitted under a regulation or ordinance are not eligible for this credit. The credit allowed under this section may not exceed five hundred thousand dollars ($500,000). To support the credit allowed by this section, the taxpayer must file with ~~its~~ the income tax ~~return,~~return for the taxable year in which the credit is ~~claimed, a certification by the Department of Environment and Natural~~

~~Resources that the property donated is suitable for one or more of the valid public benefits set forth in this subsection.~~claimed the following:

(1) A certification by the Department of Environment and Natural Resources that the property donated is suitable for one or more of the valid public benefits set forth in this subsection.

(2) A self-contained appraisal report or summary appraisal report as defined in Standards Rule 2-2 in the latest edition of the Uniform Standards of Professional Appraisal Practice as promulgated by the Appraisal Foundation for the property. For fee simple absolute donations of real property, a taxpayer may submit documentation of the county's appraised value of the donated property, as adjusted by the sales assessment ratio, in lieu of an appraisal report.

(b) The credit allowed by this section may not exceed the amount of tax imposed by this Part for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

(c) Any unused portion of this credit may be carried forward for the next succeeding five years.

(d) That portion of a qualifying donation that is the basis for a credit allowed under this section is not eligible for deduction as a charitable contribution under G.S. 105-130.9."

SECTION 2. G.S. 105-151.12 reads as rewritten:

"**§ 105-151.12. Credit for certain real property donations.**

(a) ~~A person who~~An individual or pass-through entity that makes a qualified donation of an interest in real property located in North Carolina during the taxable year that is useful for (i) public beach access or use, (ii) public access to public waters or trails, (iii) fish and wildlife conservation,~~ or (iv) other similar land conservation purposes~~(iv) forestland or farmland conservation, (v) watershed protection, (vi) conservation of natural areas as that term is defined in G.S. 113A-164.3(3), (vii) conservation of natural or scenic river areas as those terms are used in G.S. 113A-34, (viii) conservation of predominantly natural parkland, or (ix) historic landscape conservation is allowed a credit against the tax imposed by this Part equal to twenty-five percent (25%) of the fair market value of the donated property interest. To be eligible for this credit, the interest in property must be donated in perpetuity to and accepted by the State, a local government, or a body that is both organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions under the Code. Lands required to be dedicated pursuant to local governmental regulation or ordinance and dedications made to increase building density levels permitted under a regulation or ordinance are not eligible for this credit. ~~The credit allowed under this section may not exceed two hundred fifty thousand dollars ($250,000).~~ To support the credit allowed by this section, the taxpayer must file with the income tax return for the taxable year in which the credit is claimed ~~a certification by the Department of Environment and Natural Resources that the property donated is suitable for one or more of the valid public benefits set forth in this subsection.~~the following:

(1) A certification by the Department of Environment and Natural Resources that the property donated is suitable for one or more of the valid public benefits set forth in this subsection. The certification for a qualified donation made by a pass-through entity must be filed by the pass-through entity.

(2) A self-contained or summary appraisal report as defined in Standards Rule 2-2 in the latest edition of the Uniform Standards of Professional Appraisal Practice as promulgated by the Appraisal Foundation for the property. For fee simple absolute donations of real property, a taxpayer may submit documentation of the county's appraised value of the donated property, as adjusted by the sales assessment ratio, in lieu of an appraisal report.

(a1) Individuals. – The aggregate amount of credit allowed to an individual in a taxable year under this section for one or more qualified donations, whether made directly or indirectly as owner of a pass-through entity, may not exceed two hundred fifty thousand dollars ($250,000). In the case of property owned by a married couple, if both spouses are required to file North Carolina income tax returns, the credit allowed by this section may be claimed only if the spouses file a joint return. If only one spouse is required to file a North Carolina income tax return, that spouse may claim the credit allowed by this section on a separate return.

(a2) Pass-Through Entities. – The aggregate amount of credit allowed to a pass-through entity in a taxable year under this section for one or more qualified donations, whether made directly or indirectly as owner of another pass-through entity, may not exceed five hundred thousand dollars ($500,000). Each individual who is an owner of a pass-through entity is allowed as a credit an amount equal to the owner's allocated share of the credit to which the pass-through entity is eligible under this subsection, not to exceed two hundred fifty thousand dollars ($250,000). Each corporation that is an owner of a pass-through entity is allowed as a credit an amount equal to the owner's allocated share of the credit to which the pass-through entity is eligible under this subsection, not to exceed five hundred thousand dollars ($500,000).

(b) The credit allowed by this section may not exceed the amount of tax imposed by this Part for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer.

Any unused portion of this credit may be carried forward for the next succeeding five years.

(c) Repealed by Session Laws 1998-212, s. 29A.13(b).

~~(d) In the case of property owned by a married couple, if both spouses are required to file North Carolina income tax returns, the credit allowed by this section may be claimed only if the spouses file a joint return. If only one spouse is required to file a North Carolina income tax return, that spouse may claim the credit allowed by this section on a separate return.~~

(e) In the case of marshland for which a claim has been filed pursuant to G.S. 113-205, the offer of donation must be made before December 31, 2003 to qualify for the credit allowed by this section.

~~(f) Notwithstanding G.S. 105-269.15, the maximum dollar limit that applies in determining the amount of the credit applicable to a partnership that qualifies for the credit applies separately to each partner.~~"

SECTION 3. This act becomes effective for taxable years beginning on or after January 1, 2007.

BILL ANALYSIS

DRAFT 2007-MCxz-17:
Conservation Tax Credit Modifications

Committee:	Revenue Laws Study Committee	**Date:**	January 12, 2007
Introduced by:		**Summary by:**	Dan Ettefagh
Version:			Committee Counsel

SUMMARY:* *This legislative proposal would equalize the cap for the conservation tax credit for corporations and pass-through entities at $500,000. The bill would also require any taxpayer claiming the credit to support the claim's represented value of the real property donation by using either certain appraisal reports or the county's appraisal value as adjusted by the sales assessment ratio. Finally, the bill narrows the conservation purposes which qualify the land for a credit.

CURRENT LAW: Under current law, a taxpayer receives an income tax credit for certain donations of real property located in North Carolina. The amount of the credit is 25% of the fair market value of the donated property interest, capped at $250,000 for individuals and $500,000 for corporations. To be eligible for the credit, the land must be useful for (i) public beach access or use, (ii) public access to public waters or trails, (iii) fish and wildlife conservation, or (iv) other similar land conservation purposes, and the land must be donated in perpetuity to and accepted by the State, a local government, or a body organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions.

In support of the claim of the credit, a taxpayer is required to file with the income tax return a certification by DENR that the property is suitable for the statutorily listed conservation purposes. DENR does not review the documentation in an effort to verify the taxpayer's representation as to the fair market value of the donated property interest.

BILL ANALYSIS: Prior to January 1, 2007, the $250,000 cap for individuals claiming a conservation tax credit was not applied to pass-through entities as a whole. Rather, the pass-through entity received tax credits of up to $250,000 for each member making a qualifying donation. After January 1, 2007, pass-through entities were eligible only for a credit of $250,000 while corporations were eligible for a credit of $500,000. This legislative proposal raises the conservation tax credit dollar limitation for pass-through entities to $500,000 in order to bring the credit to the same level as that which is available to corporate taxpayers.

This bill also addresses concerns regarding the accuracy of the stated fair market value of donated property interests. Current law does not require any specific documentation, other than a certification by DENR of a proper conservation purpose, to establish the fair market value of the donation. The Department has reported problems associated with taxpayer use of restricted appraisal reports to establish the fair market value of the donation. Restricted appraisal reports are reports done specifically for one person and contain little or no information relied upon by the appraiser to formulate the property's value. The bill addresses this issue by requiring a taxpayer claiming the credit to submit as support for the credit either a self-contained or a summary appraisal report, which are two types of reports defined by Standards rule 2-2 of the Uniform Standards of Professional Appraisal Practice and required to have certain information included supporting the valuation determination. A taxpayer may elect, for fee simple donations of property only, to use the county's appraised value of the property as adjusted by the sales assessment ratio.

Under current law, the qualifying conservation purposes include the catch-all phrase, "other similar land conservation purposes." Differences in the statutory construction of this phrase developed between DENR and Revenue. The bill addresses this discrepancy by eliminating this phrase and substituting six, new, specific conservation purposes: forestland or farmland conservation, watershed protection, conservation of natural areas as that term is defined in G.S. 113A-164.3(3), conservation of natural or scenic river areas as those terms are used in G.S. 113A-34, conservation of predominantly natural parkland, or historic landscape conservation.

EFFECTIVE DATE: This bill would become effective for taxable years beginning on or after January 1, 2007.

BACKGROUND: The conservation tax credit was enacted in 1983 with a dollar limitation for all taxpayers of $5,000. That cap was raised in 1989 (to $25,000 for all taxpayers), 1997 (to $100,000 for individuals and $250,000 for corporations), and in 1999 (to $250,000 for individuals and $500,000 for corporations).

In 2001, the Revenue Laws Study Committee proposed that North Carolina begin applying dollar amount limitations of most tax credits to pass-through entities as a whole as well as to each individual partner. Doing so brought North Carolina into conformity with how federal law allowed pass-through entities to take tax credits. While the original proposal applied to the conservation tax credit, the bill that was ultimately enacted excluded the conservation tax credit and preserved the historic treatment of pass-through entities taking the tax credit by applying the cap only to the individual members of the pass-through entity and not to the entity as a whole. Accordingly, the conservation tax credit available to pass-through entities was the statutory dollar amount limitation multiplied by the number of members within the pass-through entity making a qualifying real property interest donation. This exception, originally set to expire in 2005, was twice extended, thus preserving this treatment of pass-through entities for purposes of the conservation tax credit to January 1, 2007. After January 1, 2007, pass-through entities were limited, as were all individual taxpayers, to a cap of $250,000.

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GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: January 19, 2007

TO: Revenue Laws Study Committee

FROM: Barry Boardman
Fiscal Research Division

RE: Draft 2007-MCxz-17

FISCAL IMPACT

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

	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12
REVENUES:	See "Assumptions and Methodology"				
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE: January 1, 2007

BILL SUMMARY: This legislative proposal would equalize the cap for the conservation tax credit for corporations and pass-through entities at $500,000. The bill would also require any taxpayer claiming the credit to support the claim's represented value of the real property donation by using either certain appraisal reports or the county's appraisal value as adjusted by the sales assessment ratio. Finally, the bill narrows the conservation purposes that qualify the land for a credit.

ASSUMPTIONS AND METHODOLOGY: Based on discussions with the Department of Revenue, there is not sufficient data available for an accurate assessment of the fiscal impact from the proposed changes in the bill. Fiscal Research thinks that while raising the cap on pass through entities may lead to granting higher tax credits for donated lands, the improved valuation guidelines and a more narrowly defined conservation purpose may offset the increased credit cap for pass through entities. Without sufficiently detailed data, it is not possible to measure the impact the modifications in the bill will have on the conservation tax credit.

SOURCES OF DATA: None

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #5

STREAMLINED SALES TAX CHANGES

LEGISLATIVE PROPOSAL #5

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO AMEND THE SALES TAX DEFINITIONS TO COMPLY WITH THE STREAMLINED SALES TAX AGREEMENT AND TO MAKE OTHER SALES TAX CHANGES.

SHORT TITLE: Streamlined Sales Tax Changes.

SPONSORS:

BRIEF OVERVIEW: This proposal would make various changes in the sales tax laws, as recommended by the Department of Revenue:

- Defines "bundled transactions" and modifies the definition of "Sales price" to keep North Carolina in compliance with the national Streamlined Sales Tax Agreement.
- Recognizes for-hire boats as commercial fishing operations eligible for the tax exemption for items sold for use in commercial fishing.
- Makes conforming and technical changes.

FISCAL IMPACT: This draft bill contains several provisions that may result in a fiscal impact.

EFFECTIVE DATE: This act would become effective October 1, 2007

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

U D

BILL DRAFT 2007-RBxz-8 [v.3] (01/23)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/30/2007 10:56:47 AM

Short Title: Streamlined Sales Tax Changes. **(Public)**

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO AMEND THE SALES TAX DEFINITIONS TO COMPLY WITH THE STREAMLINED SALES TAX AGREEMENT AND TO MAKE OTHER SALES TAX CHANGES.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-164.3 reads as rewritten:

"**§ 105-164.3. Definitions.**

The following definitions apply in this Article:

(1) Ancillary service. – A service associated with or incidental to the provision of a telecommunications service. The term includes detailed communications billing, directory assistance, vertical service, and voice mail service. A vertical service is a service, such as call forwarding, caller ID, three-way calling, and conference bridging, that allows a customer to identify a caller or manage multiple calls and call connections.

(1b) Bundled transaction. – A retail sale of two or more distinct and identifiable products, at least one of which is taxable and one of which is exempt, for one non-itemized price. Products are not sold for one non-itemized price if an invoice or another sales document made available to the purchaser separately identifies the price of each product. A bundled transaction does not include the retail sale of any of the following:

a. A product and any packaging item that accompanies the product and is exempt under G.S. 105-164.13(23).

b. A sale of two or more products whose combined price varies, or is negotiable, depending on the products the purchaser selects.

c. A sale of a product accompanied by a transfer of another product with no additional consideration.

d. A product and the delivery or installation of the product.

e. A product and any service necessary to complete the sale.

~~(1a)~~(1d) Business. – Includes any activity engaged in by any person or caused to be engaged in by him with the object of gain, profit, benefit or advantage, either direct or indirect. The term "business" shall not be construed in this Article to include occasional and isolated sales or transactions by a person who does not hold himself out as engaged in business.

~~(1b)~~(1f) Cable service. – The one-way transmission to subscribers of video programming or other programming service and any subscriber interaction required to select or use the service.

…

(12) Gross sales. – The sum total of the sales price of all retail sales of tangible personal property ~~as defined herein, whether for cash or credit without allowance for cash discount and without any deduction on account of the cost of the property sold, the cost of materials used, labor or service costs, interest paid or any other expenses whatsoever and without any deductions of any kind or character except as provided in this Article.~~ and services.

…

(37) Sales price. – The total amount or consideration for which tangible personal property or services are sold, leased, or rented. The consideration may be in the form of cash, credit, property, or services. The sales price must be valued in money, regardless of whether it is received in money.

a. 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 taxable and exempt personal property are bundled together and sold by the retailer as a single product or piece of merchandise.~~
7. Credit for trade-in.

8. Discounts that are reimbursable by a third party and can be determined at the time of sale through any of the following:

a. Presentation by the consumer of a coupon or other documentation.

b. Identification of the consumer as a member of a group eligible for a discount.

c. The invoice the retailer gives the consumer.

b. The term does not include any of the following:

1. ~~Discounts, including cash, term, or coupons, that are not reimbursed~~ Discounts that are not reimbursable by a third party, are allowed by the retailer, and are taken by a consumer on a sale.

2. Interest, financing, and carrying charges from credit extended on the sale, if the amount is separately stated on the invoice, bill of sale, or a similar document given to the consumer.

3. Any taxes imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the consumer.

…

(45a) Streamlined Agreement. – The Streamlined Sales and Use Tax Agreement as amended ~~in November 2005.~~as of December 14, 2006.

SECTION 2. G.S. 105-164.4D, as enacted by Section 5 of S.L. 2006-151, reads as rewritten:

"**§ 105-164.4D. Bundled ~~services.~~transactions.**

~~When a taxable service is bundled with a service that is not taxable, the tax applies to the gross receipts from the taxable service in the bundle as follows:~~

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

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

Tax applies to the sales price of a bundled transaction unless the bundled transaction includes a service and the retailer determines an allocated price for each product in the bundled transaction based on a reasonable allocation of revenue that is supported by the retailer's business records kept in the ordinary course of business. In this circumstance, the tax applies to the allocated price of each taxable product in the bundled transaction."

SECTION 3. G.S. 105-164.12B reads as rewritten:

"**§ 105-164.12B. Tangible personal property ~~bundled~~ sold below cost with conditional service contract.**

~~(a) Bundled Transaction Defined. – A bundled transaction is a transaction in which all of the following conditions are met:~~

~~(1) A seller transfers an item of tangible personal property to a consumer on the condition that the consumer enter into an agreement to purchase services on an ongoing basis for a minimum period of at least six months.~~

~~(2) The agreement requires the consumer to pay a cancellation fee to the service provider if the consumer cancels the contract for services within the minimum period.~~

~~(3) For the item transferred, the seller:~~

~~a. Does not charge the consumer; or~~

~~b. Charges the consumer a price that, after any discount or rebate the seller gives the consumer, is below the purchase price the seller paid for the item.~~

~~(b) Bundled Transaction Is a Sale; Sales Price. – If a seller transfers an item of tangible personal property as part of a bundled transaction, a sale has occurred, and the sales price of the item is presumed to be the retail price at which the item would sell if no agreement for services were entered into. Part of this price may be paid by the consumer at the time of the transfer; the remainder of the price is considered paid as part of the price to be paid for the services contracted for. Sales tax is due on any part of the price paid by the consumer at the time of the transfer.~~

~~(c) No Additional Sales Tax if Services Taxed. – If the services for which the consumer was required to contract are subject to services taxes at a combined rate equal to or greater than the combined State and local general rate of sales and use tax, then no additional sales tax is due on the transfer. However, if the consumer cancels the contract for services before the expiration of the minimum period, sales tax applies to the cancellation fee paid by the consumer.~~

~~(d) Additional Sales Tax if Services Not Taxed. – If the services for which the consumer was required to contract are not subject to services taxes at a combined rate equal to or greater than the combined State and local general rate of sales and use tax, then sales tax is due at the time of the transfer on the remainder of the sales price not paid at that time.~~

~~(e) Services Taxes Defined. – For the purpose of this section, the term "services taxes" means any combination of State franchise tax on gross receipts, State sales tax, or local sales tax levied on the sale of or gross receipts from the services.~~

~~(f) Determination of Purchase Price. – For the purpose of this section, the purchase price a seller paid for an item is presumed to be no greater than the price the~~

~~seller paid for the same model within 12 months before the bundled transaction, as shown on the seller's invoices.~~

(a) Conditional Service Contract Defined. – A conditional service contract is a contract in which all of the following conditions are met:

(1) A seller transfers an item of tangible personal property to a consumer on the condition that the consumer enter into an agreement to purchase services on an ongoing basis for a minimum period of at least six months.

(2) The agreement requires the consumer to pay a cancellation fee to the seller if the consumer cancels the services within the minimum period.

(3) For the item transferred, the seller charges the consumer a price that, after any price reduction the seller gives the consumer, is below the purchase price the seller paid for the item. The seller's purchase price is presumed to be no greater than the price the seller paid, as shown on the seller's purchase invoice, for the same item within 12 months before the seller transferred the item to the consumer.

(b) Tax. – If a seller transfers an item of tangible personal property as part of a conditional service contract, a sale has occurred. The sales price of the item is presumed to be the retail price at which the item would sell in the absence of the conditional service contract. Sales tax is due at the time of the transfer on the following:

(1) Any part of the presumed sales price the consumer pays at that time, if the service in the contract is taxable at the combined general rate.

(2) The presumed sales price, if the service in the contract is not taxable at the combined general rate."

SECTION 4. G.S. 105-164.13(9) reads as rewritten:

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

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

Agricultural Group.

….

(9) ~~Sales of boats,~~ Boats, fuel oil, lubricating oils, machinery, equipment, nets, rigging, paints, parts, accessories, and supplies sold to ~~persons~~ any of the following:

a. The holder of a standard commercial fishing license issued under G.S. 113-168.2 for principal use ~~by them principally~~ in commercial fishing ~~operations within the meaning of G.S. 113-168, except when the property is for use by persons principally to take fish for recreation or personal use or consumption.~~ operations.

b. The holder of a shellfish license issued under G.S. 113-169.2 for principal use in commercial shellfishing operations.

c. The operator of a for hire boat, as defined in G.S. 113-174, for principal use in the commercial use of the boat. ~~As used in this subdivision, "fish" is defined as in G.S. 113-129(7).~~"

SECTION 5. G.S. 105-164.42L reads as rewritten:

"**§ 105-164.42L. Databases on taxing jurisdictions.**

The Secretary may develop databases that provide information on the boundaries of taxing jurisdictions and the tax rates applicable to those taxing jurisdictions. A ~~seller that~~ person who relies on the information provided in these databases is not liable for underpayments of tax attributable to erroneous information provided by the Secretary in those databases."

SECTION 6. This act becomes effective October 1, 2007.

BILL ANALYSIS

BILL DRAFT 2007-RBxz-8: Streamlined Sales Tax Changes

Committee:	Revenue Laws Study Committee	**Date:**	January 23, 2007
Introduced by:		**Summary by:**	
Version:	Draft		

SUMMARY: Draft 2007-RBxz-8 makes various changes in the sales tax laws, as recommended by the Department of Revenue. The changes become effective October 1, 2007. The proposal:

- Defines "bundled transactions" and modifies the definition of "sales price" to keep North Carolina in compliance with the national Streamlined Sales Tax Agreement.
- Recognizes for-hire boats as commercial fishing operations eligible for the sales tax exemption for items sold for use in commercial fishing.
- Makes conforming and technical changes.

BILL ANALYSIS: North Carolina needs to make two definitional changes by January 1, 2008, to comply with the latest amendments to the Streamlined Sales Tax Agreement. One change is to add a definition of "bundled transaction" and specify how these transactions are to be taxed. The other change is to modify the definition of "sales price" to clarify how third-party discounts, such as a manufacturer's coupon, affect the sales price of an item.

<u>Bundled Transactions</u>

A "bundled transaction" is the sale of an exempt product and a taxable product for one price. Examples include a gift basket that contains fruit and candy and a service package consisting of internet service and phone service. Fruit is exempt from State sales tax while candy is taxable. Internet service is exempt from sales tax while phone service is taxable.

The proposal provides that a bundled transaction is taxable as follows:

1. A bundle of tangible products is taxable on the sales price of the bundle unless it meets either the 50% test or the 10% test.

   a. Under the 50% test, at least 50% of the price of the products in the bundle is attributable to food and medical items that are exempt from State tax. If the bundle meets this test, it is not taxable under State sales tax and is not taxable under local sales tax unless more than 10% of the bundle's price is attributable to food. In this circumstance, the bundle containing food is taxable under the local sales tax at the rate of 2%, which is the rate that applies to food that is not part of a bundle.

   b. Under the 10% test, no more than 10% of the price of the products in the bundle is attributable to taxable items. This test sets a *de minimus* threshold. If the bundles meets this test, it is not taxable under State or local sales tax.

2. A bundle of products that includes services is subject to the 10% test and can be subject to tax based on the allocated price of the taxable services in the bundle. To be taxed based on part of the sales price, the retailer's accounting records must allocate revenue to the services in the bundle and provide a basis for determining the proportion of the bundle's price that is attributable to each service in the bundle. If the records do not provide for this, the sales price of the bundle is taxable, assuming the taxable services exceed the *de minimus* threshold.

The taxation of bundled transactions under the proposal is the same as under current law. Currently, the sales price of a bundle of tangible products is taxable. Thus, if any item in the bundle is taxable, the entire bundle is taxable. With respect to services, current law allows for the application of tax to part of the sales price, based on the allocation of revenue to the taxable services in the bundle.

Sections 1, 2, and 3 of the proposal make the bundled transaction changes. New G.S. 105-164.3(1b), in Section 1 of the proposal, sets out the new definition of a bundled transaction and makes a conforming change to the definition of sales price in G.S. 105-164.3(37) by deleting the provisions in paragraph 6 of that definition that address bundled transactions. The revisions to G.S. 105-164.4D, in Section 2 of the proposal, specify how bundled transactions are to be taxed.

Section 3 makes conforming changes to the existing law on below-cost sales of items transferred as part of a contract for services to avoid conflicting uses of the same term. Current law, in G.S. 105-164.12B, describes the below-cost sale and contract as a bundled transaction. The transaction described in G.S. 105-164.12B is not a bundled transaction under the new definition of that term. The proposal therefore rewrites G.S. 105-164.12B to describe the transaction in that section as a conditional service contract and eliminates provisions that are no longer needed due to the taxation of telecommunications services at the combined general State and local rate.

Sales Price

The second definitional change needed to conform to the Streamlined Sales Tax Agreement is a change in the definition of "sales price." Section 1 of the draft amends the definition in G.S. 105-164.3(37) to add new paragraph 8 that specifies when a manufacturer's discount or other discount is considered part of the sales price. Current law excludes some discounts from the definition of sales price but does not address the subject as fully as the proposed change. A price discount is part of the sales price if the retailer receives reimbursement from a third-party in the amount of the discount. For example, if a customer has a $1.00 manufacturer's coupon for paper towels that cost $4.00, sales tax is due on the sales price of $4.00 rather than $3.00 because the full amount ($4.00) is paid for the paper towels when the amount paid by the customer and the manufacturer are combined. The amendment does not change the current law on this subject.

Other Changes

The draft makes the following clarifying changes:

1. It updates the reference to the Streamlined Sales Tax Agreement to include the latest amendments to that Agreement. (G.S. 105-164.3(45a) in Section 1).
2. It revises the sales tax exemption for items sold for use in commercial fishing to insert references to holders of a commercial fishing license, a commercial shellfish license, and the operator of a for-hire boat. The reference to the operator of a for-hire boat is an addition to the statute, but reflects the administrative practice of including this group in the commercial fishing group. (Section 4)
3. It clarifies that anyone who relies on the taxing jurisdiction database developed by the Department to determine the rate of sales tax applicable in a jurisdiction is not liable for any tax underpayments attributable to reliance on that database. This is the result under current law because the database is a written statement of the Department under G.S. 105-264. (Section 5).
4. It revises the definition of "gross sales" in G.S. 105-164.3(12) to eliminate inconsistencies between this definition and the definition of "sales price." Under current law, the definition of gross sales repeats part of the definition of sales price. This repetition is unnecessary and creates confusion. (Section 1).

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

<u>**FISCAL ANALYSIS MEMORANDUM**</u>

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. <u>This is not an official fiscal note</u>. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: January 31, 2007

TO: Revenue Laws Study Committee

FROM: Brenna Erford
Fiscal Research Division

RE: FM Draft 2007-RBxz-8

FISCAL IMPACT

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

	FY 2007-08	**FY 2008-09**	**FY 2009-10**	**FY 2010-11**	**FY 2011-12**
REVENUES:	**See Assumptions & Methodology**				

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

EFFECTIVE DATE: October 1, 2007

BILL SUMMARY: In order to comply with the latest amendments to the Streamlined Sales Tax Agreement, North Carolina must make two definitional changes by January 1, 2008. One change is to add a definition of "bundled transaction." The other change is to modify the definition of "sales price" to clarify how third-party discounts, such as a manufacturer's coupon, affect the sales price of an item. This draft bill incorporates those changes and makes several other changes in the sales tax laws, as recommended by the Department of Revenue. The bill:

- Defines "bundled transactions" according to the national Streamlined Sales Tax Agreement (SSTA).
- Changes the definition of "sales price" to conform with SSTA.

- Recognizes for-hire boats as commercial fishing operations eligible for the sales tax exemption for items sold for use in commercial fishing.
- Makes conforming and technical changes.

ASSUMPTIONS AND METHODOLOGY: This draft bill contains several provisions that may result in a fiscal impact.

Bundled Transactions (Sections 1, 2, 3, and 6)
This draft bill adopts the definition of "bundled transaction" set forth in the most current version of the Streamlined Sales Tax Agreement, but does not adopt the SSTA's *de minimis* test for determining the taxability of bundled transactions.[1] In short, a bundled transaction is the sale of an exempt product and a taxable product for one price.

Under current State law, the sales price of a bundle of tangible products is taxable regardless of the tax status of items that may be included in the "bundle." Therefore, the definitional change in this draft bill would not significantly alter the Department of Revenue's current treatment of bundled transactions and therefore has no revenue impact.

Sales Price (Section 1)
The definition of "sales price" adopted by the SSTA Governing Board is very similar to that in current North Carolina tax law. A small positive fiscal impact is possible from cigarette retailers who reflect a distributor's "buy-down" discount on their invoices. If the discount is shown on the invoice, it is included in the sales price. However, if the discount is not shown separate from the sales price, it is part of the sales price. Due to this technicality, a small increase in revenues may result from the actions of retailers who reflect distributor discounts on their invoices, but it is likely that this practice will become less common over time as retailers realize its tax implications.

Other Changes (Sections 1, 4, and 5)
The remaining changes in this bill are technical and clarifying in nature, and are not expected to result in any significant fiscal impact.

SOURCES OF DATA: Department of Revenue, Streamlined Sales Tax Agreement

TECHNICAL CONSIDERATIONS: Under the Streamlined Sales Tax Agreement, a state must adopt the definition of 'bundled transaction' that is contained in the SSTA **and** it must tax bundled transactions in the way provided under the SSTA. Under the SSTA, a bundled transaction is exempt from tax if less than 10% of the bundle is attributable to taxable items or, in the case of a bundle that includes food or medicine, more than 50% of the bundle is attributable to food or medicine. These tests are referred to as the '*de minimis* test'.

The proposal the Revenue Laws Study Committee considered at its December meeting adopted substantially the same provisions that are in the SSTA. However, Committee members expressed concern that the tests outlined in the SSTA for a bundled transaction to be exempt would prove too difficult for retailers to administer.

At its final meeting in January, the Committee members continued to express concern over the *de minimis* tests. The Committee understood that NC could choose to tax all bundled transactions and still be considered to conform to the SSTA; it believed that a state needed to adopt the *de minimis* tests only

[1] See Technical Considerations.

if it wanted to exempt those bundled transactions from sales tax. Therefore, this proposal taxes all bundled transactions.

However, we have since learned that the State must adopt the *de minimis* test outlined in the SSTA and exempt items that meet those tests. Otherwise, the State will not be found to be in compliance with the SSTA.

LEGISLATIVE PROPOSAL #6

GIFT TAX SIMPLIFICATION

LEGISLATIVE PROPOSAL #6

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO REFORM THE STATE GIFT TAX SO THAT IT IS BASED ON THE FEDERAL GIFT TAX, AS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE.

SHORT TITLE: Simplify Gift Tax.

SPONSORS:

BRIEF OVERVIEW: This proposal would simplify the State gift tax by eliminating the tax on many gifts, by eliminating different tax rates based on the relationship between the donor and donee, and by more closely tying the State gift tax to the federal gift tax.

FISCAL IMPACT: The impact of this proposal would be to lower the amount of revenues generated. It is not possible to determine how much the decrease would be because the necessary level of detailed data needed to make this determination is not available.

EFFECTIVE DATE: The act would become effective for gifts made on or after January 1, 2008.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

U **D**

BILL DRAFT 2007-LYxz-6B [v.1] (9/20)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/23/2007 6:40:05 PM

Short Title: Simplify Gift Tax.	**(Public)**
Sponsors: .	
Referred to:	

A BILL TO BE ENTITLED

AN ACT TO REFORM THE STATE GIFT TAX SO THAT IT IS BASED ON THE FEDERAL GIFT TAX, AS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE.

The General Assembly of North Carolina enacts:

SECTION 1. Article 6 of Chapter 105 of the General Statutes is repealed.

SECTION 2. Chapter 105 of the General Statutes is amended by adding a new Article to read:

"Article 1B.

"Gift Taxes.

"**§ 105-32.20. Gift taxes; rates of tax.**

(a) Definitions. – As used in this Article, 'taxable gift' has the same meaning as under section 2503 of the Code.

(b) Tax. – A gift tax is imposed on a gift when a federal gift tax is imposed on the gift under section 2501 of the Code and any of the following applies:

(1) The donor was a resident of this State at the time the gift was made.

(2) The donor was not a resident of this State at the time the gift was made and the gift consisted of either of the following:

a. Real property or tangible personal property that was located in this State at the time the gift was made.

b. Intangible personal property that had a tax situs in this State at the time the gift was made.

(c) Rate. – The rates of tax, which are based on the value of the taxable gift, are as follows:

Amount of Taxable Gift	**Rate**
Up to $40,000	0%

Over $40,000 up to $90,000	0.8%
Over $90,000 up to $140,000	1.6%
Over $140,000 up to $240,000	2.4%
Over $240,000 up to $440,000	3.2%
Over $440,000 up to $640,000	4.0%
Over $640,000 up to $840,000	4.8%
Over $840,000 up to $1,040,000	5.6%
Over $1,040,000 up to $1,540,000	6.4%
Over $1,540,000 up to $2,040,000	7.2%
Over $2,040,000 up to $2.540,000	8.0%
Over $2,540,000 up to $3,040,000	8.8%
Over $3,040,000 up to $3,540,000	9.6%
Over $3,540,000 up to $4,040,000	10.4%
Over $4,040,000 up to $5,040,000	11.2%
Over $5,040,000 up to $6,040,000	12.0%
Over $6,040,000 up to $7,040,000	12.8%
Over $7,040,000 up to $8,040,000	13.6%
Over $8,040,000 up to $9,040,000	14.4%
Over $9,040,000 up to $10,040,000	15.2%
Over $10,040,000	16.0%

(d) Value of Gift. – The value of a gift is determined in accordance with the Code. If any property composing part of the gift is located in a state other than North Carolina, the amount of tax payable depends on whether the donor was a resident of this State at the time of the gift. If the donor was a resident of this State at the time of the gift, the amount of tax due under this section is reduced by the lesser of the amount of the gift tax paid the other state or an amount computed by multiplying the amount otherwise due by a fraction, the numerator of which is the value of the taxable gift that was located or had a tax situs in another state at the time of the gift and the denominator of which is the value of the total taxable gift. If the donor was not a resident of this State at the time of the gift, the amount of tax due under this section is an amount computed by multiplying the amount otherwise due by a fraction, the numerator of which is the value of real or tangible personal property that was located in North Carolina at the time of the gift plus the value of any intangible property that had a tax situs in North Carolina at the time of the gift and the denominator of which is the value of the taxable gift.

"**§ 105-32.21. Lien for tax; collection of tax.**

The tax imposed by this Article is a lien upon all gifts that constitute the basis for the tax for a period of 10 years from the time they are made. If the tax is not paid by the donor when due, each donee is personally liable, to the extent of his or her respective gifts, for so much of the tax as has been assessed, or may be assessed, thereon. Any part of the property comprised in the gift that has been sold by the donee to a bona fide purchaser is divested of the lien imposed by this section and the lien, to the extent of the value of the gift, shall attach to all the property of the donee (including after-acquired property) except any part sold to a bona fide purchaser.

If the tax is not paid within 30 days after it has become due, the Department of Revenue may use any of the methods authorized in this Subchapter for the collection of other taxes to enforce the payment of taxes assessed under this Article.

In any proceeding by warrant or otherwise to enforce the collection of the tax, the donor is liable for the full amount of the tax due by reason of all the gifts constituting the basis for the tax, and each donee is liable only for so much of the tax as may be due on account of his or her respective gift.

"**§ 105-32.22. Death of donor within three years; time of assessment.**

If a donor dies within three years after filing a return, gift taxes may be assessed at any time within those three years, or on or before the date of final settlement of the donor's State estate taxes, whichever is later.

"**§ 105-32.23. When return required; due date of tax and return.**

(a) When Return Required. – A gift tax return must be filed under this Article if a federal gift tax return is required. The return must be filed on a form provided by the Secretary.

(b) Due Date. – The gift tax imposed by this Article is due when the gift tax return is due. The gift tax return is due on the date a federal gift tax return is due.

(c) Extension. – An extension of time to file a federal gift tax return is an automatic extension of the time to file a gift tax return under this Article. The Secretary may, in accordance with G.S. 105-263, extend the time for filing a gift tax return or paying the tax imposed under this Article.

(d) Administration. – Article 9 of this Chapter applies to this Article.

"**§ 105-32.24. Federal corrections.**

If the amount of a taxpayer's taxable gifts is corrected or otherwise determined by the federal government, the taxpayer must, within six months after being notified of the correction or final determination by the federal government, file a gift tax return with the Secretary of Revenue reflecting the corrected or determined taxable gifts. The Secretary of Revenue shall determine from all available evidence the taxpayer's correct tax liability for the taxable year. As used in this section, the term 'all available evidence' means evidence of any kind that becomes available to the Secretary from any source, whether or not the evidence was considered in the federal correction or determination.

The Secretary shall assess and collect any additional tax due from the taxpayer as provided in Article 9 of this Chapter. The Secretary shall refund any overpayment of tax as provided in Article 9 of this Chapter. A taxpayer who fails to comply with this section is subject to the penalties in G.S. 105-236 and forfeits the right to any refund due by reason of the determination."

SECTION 3. This act becomes effective January 1, 2008, and applies to gifts made on or after that date.

DRAFT 2007-LYxz-6B: Simplify Gift Tax

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 24, 2007
Introduced by:		**Summary by:**	Canaan Huie Committee Counsel
Version:	2007-LYxz-6B		

***SUMMARY:** This bill would simplify the State gift tax by eliminating the tax on many gifts, by eliminating different tax rates based on the relationship between the donor and donee, and by more closely tying the State gift tax to the federal gift tax. This bill would become effective for gifts made on or after January 1, 2008.*

CURRENT LAW: Under the North Carolina gift tax gifts not exceeding a value of $12,000 from any particular donor to any particular donee are excluded from taxation.[1] In addition, several types of gifts, such as gifts to cover medical or educational expenses, gifts between spouses, or charitable contributions, are not subject to the gift tax. After applying these exclusions, gifts are taxed at varying graduated rates based on the relationship between the donor and the donee. Gifts that are made to lineal descendants, lineal ancestors, adopted children, or stepchildren are taxed at the lowest rates and are subject to a lifetime cumulative exemption of $100,000. Gifts that are made to siblings, descendants of siblings, or aunts or uncles by blood are taxed at higher rates and do not enjoy the benefit of the exemption. Gifts that are made to other donees are taxed at the highest rates and do not enjoy the benefit of the exemption. Thus, North Carolina's gift tax rate structure favors transfers to children and parents by giving those transfers the lowest rates and an exemption and prefers transfers to other close family members over transfers to more distant relatives or to persons who are not related. Other than a change in the annual exclusion amount from a flat rate of $10,000 to the amount of the annual exclusion amount set under the Code, the General Assembly has not enacted any major changes to the gift tax since before 1998.

North Carolina's gift tax is similar to the federal gift tax in some limited ways, but is extremely different in some other important ways. As with the North Carolina gift, the federal gift tax has an annual exclusion amount and excludes gifts to cover medical or educational expenses, gifts between spouses, and charitable contributions. However, the federal gift tax rate does not vary based on the relationship between the donor and donee. In addition, the federal gift tax is part of a somewhat unified gift-estate tax system at the federal level. As part of that system, the federal gift tax has a lifetime exemption amount of $1,000,000. This amount is much larger than the State exemption amount and is available regardless of the relationship between the donor and donee. In addition, there are sometimes differences in the valuation of a gift for State and federal tax purposes. This most commonly occurs with respect to the valuation of annuities. For State purposes, statutes mandate an interest rate of 6% be used in determining the value of the annuity; for federal purposes, the current prevailing interest rate is used.

BILL ANALYSIS: This bill would more closely conform North Carolina's gift tax to the federal gift tax. This bill would include the following key changes:

- A State gift tax would be imposed only if a federal gift tax were imposed. This is similar to the manner in which the State imposes an estate tax. By imposing a State gift tax only when

[1] The annual exclusion amount does not apply to gifts of a future interest.

a federal gift tax is due, the practical effect is to greatly increase the lifetime exemption amount. A federal tax is only due once the taxpayer's lifetime taxable gifts have exceeded $1 million; by imposing a State gift tax only when a federal tax imposed, the State effectively incorporates the $1 million lifetime exclusion amount.

- The bill eliminates different treatment of gifts based on the relationship between the donor and donee. This bill would institute a single rate structure for all taxable gifts and would effectively incorporate a single lifetime exemption amount for all types of gifts.
- The bill would conform the valuation of gifts for State purposes to the valuation of gifts for federal purposes.
- The bill would conform the rate schedule for the State gift tax to the rate schedule for the State estate tax. In most cases, this would result in the taxpayer paying tax at a significantly lower rate.

EFFECTIVE DATE: This bill would become effective for gifts made on or after January 1, 2008.

2007-LYxz-6B-SMLY

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: January 25, 2007

TO: Revenue Laws Study Committee

FROM: Barry Boardman
Fiscal Research Division

RE: Draft 2007-LYxz-6B

FISCAL IMPACT

	Yes (X)	No ( )	No Estimate Available ( )		
	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12
REVENUES:	See "Assumptions and Methodology"				
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE:

BILL SUMMARY: This bill would simplify the State gift tax by eliminating the tax on many gifts, by eliminating different tax rates based on the relationship between the donor and donee, and by more closely tying the State gift tax to the State estate tax. This bill would become effective for gifts made on or after January 1, 2008.

ASSUMPTIONS AND METHODOLOGY: The gift tax generates on average $18 million per year. The impact of this bill would be to lower the amount of revenues generated, but the impact would be less than the full $18 million generated on average by the current gift tax.

The estate tax rates and taxable amounts are significantly different from the current gift tax. For example, the tax rate on the taxable amount of $90,000 would be 0.8 percent using the estate tax rate schedule, and would generate $720 in tax revenue. However, a $90,000 taxable gift would be taxed at a rate of 4.0 percent when the donee is the lineal issue under the current gift tax, and would generate $3,600 (the rate could be as high as 11 percent depending on the relationship with the donor).

Accurately assessing the fiscal impact from applying the State's estate tax rate schedule to gifts would require, at the minimum, historical data on the number and size of gifts taxed under the current North Carolina gift tax. Discussions with the Department of Revenue indicate this level of detailed, historical data on the gift tax is not compiled. Because that level of detailed data is not available, it is not possible to determine the impact from conforming the State gift tax to the estate tax.

SOURCES OF DATA: None

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #7

ADDITIONAL TAX ON PROPERTY COVERAGE CONTRACT

LEGISLATIVE PROPOSAL #7

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO ADJUST THE ADDITIONAL TAX RATE ON PROPERTY COVERGAE CONTRACTS TO BE REVENUE NEUTRAL BASED ON AN EXPANSION OF THE TAX BASE ENACTED IN S.L. 2006-196, TO INCREASE THE DISTRIBUTION OF THE TAX PROCEEDS TO THE VOLUNTEER FIRE DEPARTMENT FUND, TO AMEND THE VOLUNTEER FIRE DEPARTMENT GRANT PROGRAM TO ALLOW MORE DEPARTMENTS TO QUALIFY FOR GRANTS, AND TO MODIFY THE DISTRIBUTION OF TAX PROCEEDS TO THE LOCAL FIREMEN'S RELIEF FUNDS.

SHORT TITLE: Additional Tax on Property Coverage Contract.

SPONSORS:

BRIEF OVERVIEW: The proposal makes the following changes:

- It reduces the additional tax rate applicable to gross premiums on insurance contracts for property coverage from .85% to .74%. Last session the General Assembly broadened the base for this tax and directed the Revenue Laws Study Committee to determine the revenue neutral tax rate.
- It increases the percentage of the tax proceeds derived from the additional fire & lightning tax rate allocated to the Volunteer Fire Department Fund from 20% to 30%. This change reduces the amount of the tax proceeds allocated to the General Fund.

- It increases the cap on the grants from the Volunteer Fire Department Fund and it changes the qualifications for grants from the Volunteer Fire Department Grant Program to enable more volunteer fire departments to qualify for grants.
- It modifies the distribution of money to the local firemen's relief grant funds so that the distribution more closely resembles the current distribution.

FISCAL IMPACT: General Fund loss of $1.49 million for FY 2007-08.

EFFECTIVE DATE: Section 1 of this act is effective for taxable years beginning on or after January 1, 2008. The remainder of this act becomes effective January 1, 2008.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

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BILL DRAFT 2007-RBz-7 [v.3] (01/23)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/23/2007 7:28:51 AM

Short Title:	**Additional Tax on Property Coverage Contract.**	**(Public)**
Sponsors:	**.**	
Referred to:		

A BILL TO BE ENTITLED

AN ACT TO ADJUST THE ADDITIONAL TAX RATE ON PROPERTY COVERAGE CONTRACTS TO BE REVENUE NEUTRAL BASED ON AN EXPANSION OF THE TAX BASE ENACTED IN S.L. 2006-196, TO INCREASE THE DISTRIBUTION OF THE TAX PROCEEDS TO THE VOLUNTEER FIRE DEPARTMENT FUND, TO AMEND THE VOLUNTEER FIRE DEPARTMENT GRANT PROGRAM TO ALLOW MORE DEPARTMENTS TO QUALIFY FOR GRANTS, AND TO MODIFY THE DISTRIBUTION OF TAX PROCEEDS TO THE LOCAL FIREMEN'S RELIEF FUNDS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-228.5(d)(3), as amended by Section 3 of S.L. 2006-196, reads as rewritten:

"(3) **(Effective for taxable years beginning on or after January 1, 2008)** Additional Rate on Property Coverage Contracts. – An additional tax at the rate of ~~eighty-five hundredths percent (.85%)~~ seventy-four hundredths percent (.74%) applies to gross premiums on insurance contracts for property coverage. The tax is imposed on ten percent (10%) of the gross premiums from insurance contracts for automobile physical damage coverage and on one hundred percent (100%) of the gross premiums from all other contracts for property coverage. ~~Twenty percent (20%)~~ Thirty percent (30%) of the net proceeds of this additional tax must be credited to the Volunteer Fire Department Fund established in Article 87 of Chapter 58 of the General Statutes. Twenty-five percent (25%) of the net proceeds must be credited to the Department of Insurance for disbursement pursuant to G.S. 58-84-25. The remaining net proceeds must be credited to the General Fund.

The following definitions apply in this subdivision:

a. Automobile physical damage. – The following lines of business identified by the NAIC: private passenger automobile physical damage and commercial automobile physical damage.

b. Property coverage. – The following lines of business identified by the NAIC: fire, farm owners multiple peril, homeowners multiple peril, nonliability portion of commercial multiple peril, ocean marine, inland marine, earthquake, private passenger automobile physical damage, commercial automobile physical damage, aircraft, and boiler and machinery. The term also includes insurance contracts for wind damage.

c. NAIC. – National Association of Insurance Commissioners."

SECTION 2. G.S. 58-84-25, as amended by Section 7 of S.L. 2006-196, reads as rewritten:

§ 58-84-25. (Effective January 1, 2008) Disbursement of funds by Insurance Commissioner.

(a) Distribution. -- The Insurance Commissioner shall deduct the sum of three percent (3%) from the tax proceeds credited to the Department pursuant to G.S. 105-228.5(d)(3) and pay the same over to the treasurer of the State Firemen's Association for general purposes. The Insurance Commissioner shall deduct the sum of two percent (2%) from the tax proceeds and retain the same in the budget of the Department of Insurance for the purpose of administering the disbursement of funds by the board of trustees in accordance with the provisions of G.S. 58-84-35. The Insurance Commissioner shall, pursuant to G.S. 58-84-50, credit the amount forfeited by nonmember fire districts to the North Carolina State Firemen's Association. The Insurance Commissioner shall pay the remaining tax proceeds to the treasurer of each fire district as provided in subsection (b) of this section.

(b) Local Fire Districts. -- ~~on a per capita basis, using the most recent annual population estimates certified by the State Budget Officer.~~ The Insurance Commissioner must distribute to the fire districts the amount each district received under this section in the previous year. If the amount distributable in a year is less than the amount distributed in the previous year, then the amount each fire district receives is reduced proportionally. If the amount distributable in a year is greater than the amount distributed in the previous year, then the excess proceeds must be distributed to the counties in proportion to the premiums collected on insurance contracts for property coverage in each county compared to the total premiums collected on insurance contracts for property coverage in this State. The county must distribute any funds it receives under this section to the fire districts in its county. The amount each fire district receives is its proportionate share based upon the property tax values in its district compared to the property tax values in all the fire district of that county.

These funds shall be held by the treasurer as a separate and distinct fund. The fire district shall immediately pay the funds to the treasurer of the local board of trustees upon the treasurer's election and qualification, for the use of the board of trustees of the firemen's local relief fund in each fire district, which board shall be composed of five members, residents of the fire district as hereinafter provided for, to be used by it for the purposes provided in G.S. 58-84-35."

SECTION 3. G.S. 58-87-1, as amended by Section 8 of S.L. 2006-196, reads as rewritten:

"§ 58-87-1. (Effective January 1, 2008) Volunteer Fire Department Fund.

(a) Fund. – The Volunteer Fire Department Fund is created as an interest-bearing, nonreverting fund in the Department to provide matching grants to volunteer fire departments to purchase equipment and make capital improvements. The Commissioner shall administer the Fund. Up to two percent (2%) of the Fund may be used for additional staff and resources to administer the Fund in each fiscal year.

(a1) Grant Program. – An eligible fire department may apply to the Commissioner for a grant under this section. In awarding grants under this section, the Commissioner must, to the extent possible, select applicants from all parts of the State based upon need. The Commissioner must award the grants on May 15 of each year subject to the following limitations:

(1) The size of a grant may not exceed ~~twenty thousand dollars ($20,000);~~thirty thousand dollars ($30,000).

(2) The applicant shall match the grant on a dollar-for-dollar ~~basis;~~basis.

(3) The grant may be used only for equipment purchases, payment of highway use taxes on those purchases, or capital expenditures necessary to provide fire protection ~~services; and~~services.

(4) An applicant may receive no more than one grant per fiscal year.

(b) Eligible Fire Department. – A fire department is eligible for a grant under this section if it meets all of the conditions of this subsection. No fire department may be declared ineligible for a grant solely because it is classified as a municipal fire department.

(1) It serves a response area of ~~6,000~~12,000 or less in population. In making the population determination, the Department must use the most recent annual population estimates certified by the State Budget Officer.

(2) It consists entirely of volunteer members, with the exception that the unit may have paid members to fill the equivalent of ~~three~~ six full-time paid positions.

(3) It has been certified by the Department of Insurance.

(c) Report. – The Commissioner must submit a written report to the General Assembly within 60 days after the grants have been made. This report must contain the amount of the grant and the name of the recipient."

SECTION 4. Section 1 of this act is effective for taxable years beginning on or after January 1, 2008. The remainder of this act becomes effective January 1, 2008.

BILL DRAFT 2007-RBz-7: Additional Tax Rate on Property Coverage

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 23, 2007
Introduced by:		**Summary by:**	
Version:	Draft		

SUMMARY: Draft 2007-RBz-7 makes the following changes:

- ***It reduces the additional tax rate applicable to gross premiums on insurance contracts for property coverage from .85% to .74%. Last session the General Assembly broadened the base for this tax and directed the Revenue Laws Study Committee to determine the revenue neutral tax rate.***
- ***It increases the percentage of the tax proceeds derived from the additional fire & lightning tax rate allocated to the Volunteer Fire Department Fund from 20% to 30%. This change reduces the amount of the tax proceeds allocated to the General Fund.***
- ***It increases the cap on the grants from the Volunteer Fire Department Fund and it changes the qualifications for grants from the Volunteer Fire Department Grant Program to enable more volunteer fire departments to qualify for grants.***
- ***It modifies the distribution of money to the local firemen's relief grant funds so that the distribution more closely resembles the current distribution.***

CURRENT LAW: North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[1] In addition to the general rate, there is a 1.33% rate applied to the gross premiums on insurance policies that provide fire and lightning coverage. The taxable percentage of the different types of policies varies. Twenty-five percent of the net proceeds of this additional tax are credited to the Volunteer Fire Department Fund,[2] and the remainder is credited to the General Fund. There is also a 0.5% rate applied to gross premiums on insurance policies that provide fire and lightning coverage within fire districts. The statute authorizing the 0.5% rate does not provide any exceptions from this tax. The net proceeds of this tax are credited to the Department of Insurance.[3]

Last session, in S.L. 2006-196, the General Assembly changed the law, effective January 1, 2008, upon the recommendation of the Revenue Laws Study Committee. The Committee recommended a change in the law because the Department of Revenue informed the Committee that the taxable percentages applied under the previous law were neither statutory nor imposed by administrative rule. S.L. 2006-196

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[1] Workers' compensation policies are taxed at 2.5%. HMO policies are currently taxed at a rate of 1%; however, effective January 1, 2007, these policies will be taxed at the general rate of 1.9%.

[2] Funds in the Volunteer Fire Department Fund provide matching grants to volunteer fire departments to purchase equipment and make capital improvements. In 2005, the Department received 567 applications for grants requesting matching funds of $6,577,455. The available monies in the Fund totaled only $4,369,976. The Department approved 500 applications totaling $4,365,489.

[3] Three percent (3%) of the tax proceeds are credited to the State Firemen's Association for general purposes. Two percent (2%) of the proceeds are used by the Department of Insurance for the purpose of administering the disbursement. The remaining funds are allocated among the fire districts in proportion to the amount of business done in the district and used by the local district for firemen's local relief purposes. *See Article 84 of Chapter 58 of the General Statutes.*

set the percentages for the current taxable year and it established a new method of taxing insurance policies that provide property coverage, effective for taxable years beginning on or after January 1, 2008. Effective 2008, the act broadens the base and lowers the rate applicable to insurance contracts that provide property coverage. The 2006 act set the revenue-neutral tax rate at 0.85%, and it directed the Revenue Laws Study Committee to continue studying this issue to ensure a revenue neutral tax rate.

Under current law, there is a local tax applied to contracts of insurance applicable to fire and lightning coverage within fire districts. A portion of the revenue from this tax is distributed to these fire districts. The 2006 act broadens the base. It does not limit the application of the tax to fire districts. It also does not require the accounting by insurance companies of the amount of premiums written in fire districts. The 2006 legislation established a new method of distribution based upon a per capita allocation among fire districts, effective January 1, 2008, and directed the Revenue Laws Study Committee to study the distribution to the local fire districts.

BILL ANALYSIS: This proposal reflects the continued study of this area. The proposal makes the following changes to the law:

- It reduces the additional tax rate on property coverage contracts to ensure a revenue neutral tax rate. It clarifies that the tax rate includes wind-only premiums.
- It changes the distribution formula for the funds distributed to local fire districts. The 2006 legislation provided that the funds would be distributed on a per capita basis. Further study revealed that this distribution formula would be significantly different than the current distribution formula. This proposal changes the distribution formula so that the amounts distributed under it more closely follow the current distribution patterns.
- It increases the percentage of the tax proceeds allocated to the Volunteer Fire Department Fund from 20% to 30%. This change reduces the amount allocated to the General Fund from 55% to 45%.
- It increases the cap on the grants from the Volunteer Fire Department Fund and it changes the qualifications for grants from the Fund so that more volunteer fire departments may qualify for grants:
    - It increases the cap on the grants from $20,000 to $30,000.
    - It provides that a volunteer fire department may qualify for a grant if it serves a response area of no more than 12,000 people (current law is 6,000).
    - It provides that a volunteer fire department may qualify for a grant if it has no more than six full-time paid positions (current law is three).

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2007

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: January 23, 2007

TO: Revenue Laws Study Committee

FROM: Rodney Bizzell
Fiscal Research Division

RE: 2007-RBz-7 v.3 Additional Coverage on Property Coverage Contracts

FISCAL IMPACT ($ millions)

	Yes (X)	No ( )	No Estimate Available ( )		
	FY 2007-08	**FY 2008-09**	**FY 2009-10**	**FY 2010-11**	**FY 2011-12**
REVENUES:					
General Fund	**($1.49)**	**($3.07)**	**($3.28)**	**($3.52)**	**($3.76)**
Vol. Fire Dept. Fund	**$1.49**	**$3.07**	**$3.28**	**$3.52**	**$3.76**

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

EFFECTIVE DATE: January 1, 2008

BACKGROUND:
During the 2005-06 Session, the General Assembly enacted HB 1891, which simplified the additional tax on gross premiums for fire and lightning coverage. The bill combined the existing statewide and local taxes on this coverage and clarified the types and percentages of premiums subject to the tax. The bill also established percentages for distribution of the proceeds under the combined tax that were proportional to the distributions under the separate state and local taxes. The bill also established a tax rate for the statewide tax distribution and a new method for distributing the Firemen's Relief Fund

portion of the tax. The existing method of distribution required insurance companies to document premiums written by fire district and a simpler method was created under HB1891 to eliminate the need to track premiums by district.

BILL SUMMARY:
This bill establishes a revenue neutral rate of 0.74% for the combined statewide tax established under HB 1891. The bill also reduces the percentage of collections going to the General Fund to allow additional funding for the Volunteer Fire Department Fund. The distribution established under HB 1891 for the tax is: General Fund - 55%; Firemen's Relief Fund - 25%; and Volunteer Fire Department Fund - 20%. This bill would reduce the General Fund allocation by 10% and increase the Volunteer Fire Department Fund allocation by 10%. This bill also establishes the distribution method for the portion of the tax that is distributed for the Firemen's Relief Fund. The new distribution method provides for each department to receive the same amount it received in the previous fiscal year as a base distribution. The incremental change in the total allocation for the relief fund would be distributed to each county based on premium volume and distributed to departments within each county based on property values. Finally, the bill changes the criteria the Department of Insurance uses in providing grants to volunteer fire departments by increasing the maximum size of the grants to $30,000; increasing the maximum population of eligible districts to 12,000; and increasing the maximum number of allowed paid firefighters on staff from three to six.

ASSUMPTIONS AND METHODOLOGY:
The revenue neutral rate in the bill is derived by dividing annual collections by the taxable premiums. Information on calendar year premiums for 2005 was available from the Department of Insurance. The NC Department of Revenue provided tax collections for the period of April 2005 through March 2006, the time period for which collections most closely correspond to 2005 premiums. The rate resulting from this calculation is 0.74%.

To determine the amount of revenue loss to the General Fund related to the change in percentage allocations, fire and lightning tax collections were projected for the next five fiscal years based on the relationship between gross premiums collections and North Carolina personal income, for which projections are available from Moody's Economy.com. Both the current and proposed allocation percentages are applied to the projected fiscal year collections. The differences between the current and proposed allocations represent the annual loss and gain for the General Fund and Volunteer Fire Department Fund, respectively. Because the effective date is January 1, 2008, the impact for FY 2007-08 is partial. The new allocations would apply to installments made in April and June, which represent approximately 52% of fiscal year collections. Therefore, the General Fund revenue loss for FY 2007-08 was calculated by applying the new percentage allocation to 52% of the fiscal year revenue and applying the current allocation to the remaining portion.

Current Allocation Fire and Lightning Tax (Included in HB 1891) ($ millions)

	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12
General Fund 55%	**15.79**	**16.87**	**18.07**	**19.35**	**20.70**
Volunteer Fire Fund 20%	**5.74**	**6.13**	**6.57**	**7.04**	**7.53**
Firemen's Relief Fund 25%	**7.18**	**7.67**	**8.21**	**8.80**	**9.41**
Total	**28.71**	**30.67**	**32.85**	**35.19**	**37.64**

Proposed Allocation - Fire and Lightning Tax ($ millions)

	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12
General Fund 45%	**14.29**	**13.80**	**14.78**	**15.83**	**16.94**
Volunteer Fire Fund 30%	**7.23**	**9.20**	**9.85**	**10.56**	**11.29**
Firemen's Relief Fund 25%	**7.17**	**7.67**	**8.21**	**8.80**	**9.41**
Total	**28.71**	**30.67**	**32.85**	**35.19**	**37.64**

SOURCES OF DATA: NC Department of Revenue; NC Department of Insurance; Moody's Economy.com

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #8

REVENUE LAWS AND MOTOR FUELS TAX TECHNICAL CHANGES

LEGISLATIVE PROPOSAL #8

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2007 REGULAR SESSION OF THE 2007 GENERAL ASSEMBLY

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS, MOTOR FUELS TAX LAWS, AND RELATED STATUTES.

SHORT TITLE: Revenue Laws & Motor Fuels Tax Technical Changes.

SPONSORS:

BRIEF OVERVIEW: This proposal makes several technical, clarifying, and administrative changes to the revenue laws and related statutes.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: Except as otherwise noted in the bill, the proposal would become effective when it becomes law.

A copy of the proposed legislation and a bill analysis begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2007

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BILL DRAFT 2007-TDxz-4 [v.25] (01/08)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/24/2007 9:19:33 AM

Short Title: Revenue Laws & Motor Fuels Tax Tech. Changes. **(Public)**

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS, MOTOR FUELS TAX LAWS, AND RELATED STATUTES.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 53B-4(2) reads as rewritten:

"(2) Authorization under G.S. ~~105-251, 105-251.1,~~ 105.251 or 105-258."

SECTION 2. G.S. 105-40(7a) reads as rewritten:

"(7a) All exhibitions, performances, and entertainments promoted and managed by 'a nonprofit arts organization.' ~~organization' that is exempt from income tax under G.S. 105-130.11(a)(3).~~ This exemption does not apply to athletic events. A 'non-profit arts organization' means:

a. An organization that is exempt from income tax under G.S. 105-130.11(a)(3).

b. An organization whose primary purpose is to offer choral and theatrical performances."

SECTION 3. G.S. 105-40(10) reads as rewritten:

"(10) Arts festivals held by a person that is exempt from income tax under Article 4 of this Chapter and that meets the following conditions:

a. The person holds no more than two arts festivals during a calendar year.

b. Each of the person's arts festivals last no more than seven consecutive days.

c. The arts festivals are held outdoors on public property and involve a variety of exhibitions, entertainments, and activities."

SECTION 4. G.S.105-40(11) reads as rewritten:

"(11) Community festivals held by a person who is exempt from income tax under Article 4 of this Chapter and that meets all of the following conditions:

a. The person holds no more than one community festival during a calendar year.

b. The community festival lasts no more than seven consecutive days.

c. The community festival involves a variety of exhibitions, entertainments, and activities, the majority of which are held outdoors and are open to the public."

SECTION 5. G.S.105-113.82(a) reads as rewritten:

"(a) Amount, Method. – The Secretary shall distribute annually the following percentages of the net amount of excise taxes collected on the sale of malt beverages and wine during the preceding 12-month period ending March ~~31, less the amount of the net proceeds credited to the Department of Commerce under G.S. 105-113.81A,~~ 31 to the counties and cities in which the retail sale of these beverages is authorized in the entire county or city:

(1) Of the tax on malt beverages levied under G.S. 105-113.80(a), twenty-three and three-fourths percent (23¾%);

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

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

For purposes of this subsection, 'net amount' means gross collections less refunds and amounts credited to the Department of Commerce under G.S. 105-113.81A. If malt beverages, unfortified wine, or fortified wine may be licensed to be sold at retail in both a county and a city located in the county, both the county and city shall receive a portion of the amount distributed, that portion to be determined on the basis of population. If one of these beverages may be licensed to be sold at retail in a city located in a county in which the sale of the beverage is otherwise prohibited, only the city shall receive a portion of the amount distributed, that portion to be determined on the basis of population. The amounts distributed under subdivisions (1), (2), and (3) shall be computed separately."

SECTION 6. G.S.105-129.16E(b) reads as rewritten:

"(b) Allocation. – If the taxpayer is an individual who is a nonresident or a part-year resident, the taxpayer must reduce the amount of the credit by multiplying it by the fraction calculated under G.S. 105-134.5(b) or (c), as appropriate. If the taxpayer is not an individual and is required to apportion its multistate business income to this State, the taxpayer must reduce the amount of the credit by multiplying it by the apportionment fraction used to apportion its ~~business~~ apportionable income to this State."

SECTION 7. G.S. 105-129.87(b) reads as rewritten:

"(b) Threshold. – The applicable threshold is the appropriate amount set out in the following table based on the development tier designation of the county where the new jobs are created during the taxable year. If the taxpayer creates new jobs at more than one eligible establishment in a county during the taxable year, the threshold applies to the aggregate number of new jobs created at all eligible establishments within the county during that year. If the taxpayer creates new jobs at eligible establishments in different counties during the taxable year, the threshold applies separately to the aggregate number of new jobs created at eligible establishments in each county. If the taxpayer creates new jobs in an urban progress zone or an agrarian growth zone, the applicable threshold is the one for a development tier one area. New jobs created in an urban progress zone or an agrarian growth zone are not aggregated with jobs created at any other eligible establishments regardless of county.

Area Development Tier	**Threshold**
Tier One	5
Tier Two	10
Tier Three	15"

SECTION 8. G.S. 105-129.88(c) reads as rewritten:

"(c) Threshold. – The applicable threshold is the appropriate amount set out in the following table based on the development tier where the eligible business property is placed in service during the taxable year. If the taxpayer places business property in service in an urban progress zone or an agrarian growth zone, the applicable threshold is the one for a development tier one area. Business property placed in service in an urban progress zone or an agrarian growth zone is not aggregated with business property placed in service at any other eligible establishments regardless of county. If the taxpayer places eligible business property in service at more than one establishment in a county during the taxable year, the threshold applies to the aggregate amount of eligible business property placed in service during the taxable year at all establishments in the county. If the taxpayer places eligible business property in service at establishments in different counties, the threshold applies separately to the aggregate amount of eligible business property placed in service in each county. If the taxpayer places eligible ~~machinery and equipment~~business property in service at an establishment over the course of a two-year period, the applicable threshold for the second taxable year is reduced by the eligible investment amount for the previous taxable year.

Area Development Tier	**Threshold**
Tier One	$ -0-
Tier Two	1,000,000
Tier Three	2,000,000"

SECTION 9. G.S.105-129.88(e) reads as rewritten:

"(e) Transferred Property. – If, in one of the four years in which the installment of a credit accrues, the business property with respect to which the credit was claimed is moved to a county in a higher-numbered development tier or ~~to~~ out of an urban progress zone or an agrarian growth zone, the remaining installments of the credit are allowed only to the extent they would have been allowed if the business property had been placed in service initially in the area to which it was moved. If, in one of the four years in which the installment of a credit accrues, the business property with respect to which a credit was claimed is moved to a county in a lower-numbered development tier or an urban progress zone or an agrarian growth zone, the remaining installments of the credit shall be calculated as if the business property had been placed in service initially in the area to which it was moved."

SECTION 10. G.S. 105-130.48(e) reads as rewritten:

"(e) Documentation of Credit. – ~~To~~ Upon request, to support the credit allowed by this section, the taxpayer must file with its income tax return, for the taxable year in which the credit is claimed, a certification by the Department of Environment and Natural Resources stating the number of bushels of oyster shells donated by the taxpayer."

SECTION 11. G.S. 105-151.30(d) reads as rewritten:

"(d) Documentation of Credit. – ~~To~~ Upon request, to support the credit allowed by this section, the taxpayer must file with its income tax return, for the taxable year in which the credit is claimed, a certification by the Department of Environment and Natural Resources stating the number of bushels of oyster shells donated by the taxpayer."

SECTION 12. G.S. 105-164.13(52) reads as rewritten:

"(52) Items subject to sales and use tax under G.S. 105-164.4, other than ~~electricity and~~ electricity, telecommunications service, and ancillary service as defined in G.S. 105-164.4, if all of the following conditions are met:

(a) The items are purchased by a State agency for its own use and in accordance with G.S. 105-164.29A.

(b) The items are purchased pursuant to a valid purchase order issued by the State agency that contains the exemption number of the agency and a description of the property purchased, or the items purchased are paid for with a State-issued check, electronic deposit, credit card, procurement card, or credit account of the State agency.

(c) For all purchases other than by an agency-issued purchase order, the agency must provide to or have on file with the retailer the agency's exemption number."

SECTION 13. G.S. 105-164.16(b1) reads as rewritten:

"(b1) Monthly. – A taxpayer who is consistently liable for ~~more than~~at least one hundred dollars ($100.00) but less than ten thousand dollars ($10,000) a month in State and local sales and use taxes must file a return and pay the taxes due on a monthly basis. A monthly return is due by the 20th day of the month following the calendar month covered by the return."

SECTION 14. G.S. 105-164.16(d) reads as rewritten:

"(d) Use Tax on Out-of-State Purchases. – Use tax payable by an individual who purchases tangible personal ~~property~~property, excluding purchases of boats and aircrafts, outside the State for a nonbusiness purpose is due on an annual basis. For an individual who is not required to file an individual income tax return under Part 2 of Article 4 of this Chapter, the annual reporting period ends on the last day of the calendar year and a use tax return is due by the following April 15. For an individual who is required to file an individual income tax return, the annual reporting period ends on the last day of the individual's income tax year, and the use tax must be paid on the income tax return as provided in G.S. 105-269.14."

SECTION 15. G.S.105-164.16(d), as amended by Section 9 of S.L. 2006-33, reads as rewritten:

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

SECTION 16. G.S. 105-187.51B(a), as amended by Section 24.9(a) of S.L. 2006-66 reads as rewritten:

"(a) Tax. – A privilege tax is imposed on the following:

(1) A major recycling facility that purchases any of the following tangible personal property for use in connection with the facility:

a. Cranes, structural steel crane support systems, and foundations related to the cranes and support systems.

b. Port and dock facilities.

c. Rail equipment.

d. Material handling equipment.

e. Mill machinery parts and accessories."

SECTION 17. G.S. 105-187.52 reads as rewritten:

"§ 105-187.52. Administration.

(a) Administration. – The privilege taxes imposed by this Article are in addition to the State use tax. Except as otherwise provided in this Article, the collection and administration of these taxes is the same as the State use tax imposed by Article 5 of this Chapter.

(b) Credit. – A credit is allowed against the tax imposed by this Article for the amount of a sales or use tax, privilege or excise tax, or substantially equivalent tax paid to another state. The credit allowed by this subsection does not apply to tax paid to another state that does not grant a similar credit for the privilege tax paid in North Carolina.

(c) Exemption. State agencies are exempted from the privilege taxes imposed by this article."

SECTION 18. G.S. 105-258(a) reads as rewritten:

"(a) Secretary May Examine Data and Summon Persons. The Secretary of Revenue, for the purpose of ascertaining the correctness of any return, making a return where none has been made, or determining the liability of any person for ~~any tax imposed by this Subchapter,~~ a tax, or collecting any such tax, shall have the power to examine, personally, or by an agent designated by him, any books, papers, records, or other data which may be relevant or material to such inquiry, and the Secretary may summon the person liable for the tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, care or control of books of account containing entries relevant or material to the income and expenditures of the person liable for the tax or required to perform the act, or any other person having knowledge in the premises, to appear before the Secretary, or his agent, at a time and place named in the summons, and to produce such books, papers, records or other data, and to give such testimony under oath as may be relevant or material to such inquiry, and the Secretary or his agent may administer oaths to such person or persons. If any person so summoned refuses to obey such summons or to give testimony when summoned, the Secretary may apply to the Superior Court of Wake County for an order requiring such person or persons to comply with the summons of the Secretary, and the failure to comply with such court order shall be punished as for contempt."

SECTION 19. G.S. 105-268.1 reads as rewritten:

"**§ 105-268.1. Agreements to coordinate the administration and collection of taxes; sharing of information for statistical reports and revenue estimates.**

(a) The Secretary of Revenue is hereby authorized, with the approval of the Governor and Council of State, to enter into agreements with the United States government or any department or agency thereof, or with a state or any political subdivision thereof, for the purpose of coordinating the administration and collection of taxes imposed by this State and administered and collected by said Secretary with taxes imposed by the United States or by any other state or political subdivision thereof.

(b) The Secretary of Revenue is hereby authorized, with the approval of the Governor and Council of State, to share information with the United States government or any department or agency thereof, or with a state or any political subdivision thereof, for the purpose of obtaining data for statistical reports and revenue estimates."

SECTION 20.1. G.S. 105-449.52 reads as rewritten:

"**§ 105-449.52. Civil penalties applicable to motor carriers.**

(a) Penalty. – A motor carrier who does any of the following is subject to a civil penalty:

(1) Operates in this State or causes to be operated in this State a motor vehicle that either fails to carry the registration card required by this Article or fails to display an identification marker in accordance with this Article. The amount of the penalty is one hundred dollars ($100.00).

(2) Is unable to account for identification markers the Secretary issues the motor carrier, as required by G.S. 105-449.47. The amount of the penalty is one hundred dollars ($100.00) for each identification marker the carrier is unable to account for.

(3) Displays an identification marker on a motor vehicle operated by a motor carrier that was not issued to the carrier by the Secretary under G.S. 105-449.47. The amount of the penalty is one thousand dollars ($1,000) for each identification marker unlawfully obtained. Both the licensed motor carrier to whom the Secretary issued the identification marker and the motor carrier displaying the unlawfully obtained identification marker are jointly and severally liable for the penalty under this subdivision.

~~A~~

(a1) Payment. – A penalty imposed under this section is payable to the ~~Department of Revenue, the Department of Crime Control and Public Safety, or the Division of Motor Vehicles.~~ agency that assessed the penalty. When a motor vehicle is found to be operating without a registration card or an identification marker or with an identification marker the Secretary did not issue for the vehicle, the motor vehicle may not be driven for a purpose other than to park the motor vehicle until the penalty imposed under this section is paid unless the officer that imposes the penalty determines that operation of the motor vehicle will not jeopardize collection of the penalty.

(b) Hearing. – The procedure set out in G.S. 105-449.119 for protesting a penalty imposed under Article 36C, Part 6, of this Chapter applies to a penalty imposed under this section."

SECTION 20.2. G.S. 105-449.115(f) reads as rewritten:

"(f) Sanctions Against Transporter. – The following acts are grounds for a civil ~~penalty payable to the Department of Crime Control and Public Safety or the Department of Revenue:~~penalty:

(1) Transporting motor fuel in a railroad tank car or transport truck without a shipping document or with a false or an incomplete shipping document.

(2) Delivering motor fuel to a destination state other than that shown on the shipping document.

The penalty ~~imposed under this subsection~~ is payable to the agency that assessed the penalty and is payable by the person in whose name the conveyance is registered, if the conveyance is a transport truck, and is payable by the person responsible for the movement of motor fuel in the conveyance, if the conveyance is a railroad tank car. The amount of the penalty is five thousand dollars ($5,000). A penalty imposed under this subsection is in addition to any motor fuel tax assessed."

SECTION 20.3. G.S. 105-449.115A(c) reads as rewritten:

"(c) Sanctions. – Transporting motor fuel in a tank wagon without an invoice, bill of sale, or shipping document containing the information required by this section is grounds for a civil ~~penalty payable to the Department of Crime Control and Public Safety or the Department of Revenue.~~penalty. The penalty ~~imposed under this subsection~~ is payable to the agency that assessed the penalty and is payable by the person in whose name the tank wagon is registered. The amount of the penalty is one thousand dollars ($1,000). A penalty imposed under this subsection is in addition to any motor fuel tax assessed."

SECTION 20.4. G.S. 105-449.117(b) reads as rewritten:

"(b) Civil Penalty. – The civil penalty is payable to the ~~Department of Transportation, Division of Motor Vehicles, or the Department of Revenue~~ agency that assessed the penalty and is payable by the person in whose name the highway vehicle is registered. The amount of the penalty depends on the amount of fuel in the supply tank of the highway vehicle. The penalty is the greater of one thousand dollars ($1,000) or five times the amount of motor fuel tax payable on the fuel in the supply tank. A penalty imposed under this section is in addition to any motor fuel tax assessed."

SECTION 20.5. G.S. 105-449.118 reads as rewritten:

"**§ 105-449.118. Civil penalty for buying or selling non-tax-paid motor fuel.**

A person who dispenses non-tax-paid motor fuel into the supply tank of a highway vehicle or who allows non-tax-paid motor fuel to be dispensed into the supply tank of a highway vehicle is subject to a civil penalty of two hundred fifty dollars ($250.00) per occurrence.

The penalty is payable to the ~~Department of Transportation, Division of Motor Vehicles, or the Department of Revenue.~~ agency that assessed the penalty. Failure to pay a penalty imposed under this section is grounds under G.S. 20-88.01(b) to withhold or revoke the registration plate of the motor vehicle into which the motor fuel was dispensed."

SECTION 20.6. G.S. 105-449.118A reads as rewritten:

"**§ 105-449.118A. Civil penalty for refusing to allow the taking of a motor fuel sample.**

A person who refuses to allow the taking of a motor fuel sample is subject to a civil penalty of one thousand dollars ($1,000). The penalty is payable to the ~~Department of Transportation, Division of Motor Vehicles, or the Department of Revenue.~~ agency that assessed the penalty. If the refusal is for a sample to be taken from a vehicle, the penalty is payable by the person in whose name the vehicle is registered. If the refusal is for a sample to be taken from any other storage tank or container, the penalty is payable by the owner of the container."

SECTION 21. G.S. 105-449.72(a)(3) reads as rewritten:

"(a) Initial Bond. – An applicant for a license as a refiner, a terminal operator, a supplier, an importer, a blender, a permissive supplier, or a distributor must file with the Secretary a bond or an irrevocable letter of credit. A bond or an irrevocable letter of credit must be conditioned upon compliance with the requirements of this Article, be payable to the State, and be in the form required by the Secretary. The amount of the bond or irrevocable letter of credit is determined as follows:

(1) For an applicant for a license as any of the following, the amount is two million dollars ($2,000,000):
  a. A refiner.
  b. A terminal operator.
  c. A supplier that is a position holder or a person that receives motor fuel pursuant to a two-party exchange.
  d. A bonded importer.
  e. A permissive supplier.

(2) For an applicant for a license as any of the following, the amount is two times the applicant's average expected monthly tax liability under this Article, as determined by the Secretary. The amount may not be less than two thousand dollars ($2,000) and may not be more than five hundred thousand dollars ($500,000):
  a. ~~A supplier that is a fuel alcohol provider or a biodiesel provider but is neither a position holder nor a person that receives motor fuel pursuant to a two-party exchange.~~

b. An occasional importer.

c. A tank wagon importer.

d. A distributor.

e. Repealed by Session Laws 1997-60, s. 5, effective October 5, 1997.

(3) For an applicant for a license ~~as a blender,~~ as any of the following, a bond is required only if the applicant's average expected annual tax liability under this Article, as determined by the Secretary, is at least two thousand dollars ($2,000). When a bond is required, the bond amount is the same as under subdivision (2) of this subsection.

a. A blender.

b. A supplier that is a fuel alcohol provider or a biodiesel provider but is neither a position holder nor a person that receives motor fuel pursuant to a two-party exchange."

SECTION 22. G.S. 105-449.115(g) reads as rewritten:

"(g) Penalty Defense. – Compliance with the conditions set out in this subsection is a defense to a civil penalty imposed under subsection (f) of this section as a result of the delivery of fuel to a state other than the destination state printed on the shipping document for the fuel. The Secretary must waive a penalty imposed against a person under that subsection if the person establishes a defense under this subsection. The conditions for the defense are:

(1) The person notified the Secretary of the diversion ~~within seven days after the diversion occurred~~ and received a confirmation number for the ~~diversion.~~diversion before the imposition of the penalty.

(2) Tax was timely paid on the diverted ~~fuel.~~fuel, unless the person is a motor fuel transporter."

SECTION 23. G.S. 115D-31.3(j) reads as rewritten:

"(j) Use of funds in low-wealth counties. – Funds retained by colleges or distributed to colleges pursuant to this section may be used to supplement local funding for maintenance of plant if the college does not receive maintenance of plant funds pursuant to G.S. 115D-31.2, and if the county in which the main campus of the community college is located:

(1) Is designated as a Tier 1 or Tier 2 county in accordance with G.S. 115D-31.4;~~G.S. 105-129.3;~~

(2) Had an unemployment rate of at least two percent (2%) above the State average or greater than seven percent (7%), whichever is higher, in the prior calendar year; and

(3) Is a county whose wealth, as calculated under the formula for distributing supplemental funding for schools in low-wealth counties, is eighty percent (80%) or less of the State average.

Funds may be used for this purpose only after all local funds appropriated for maintenance of plant have been expended."

SECTION 24. Article 3 of Chapter 115D is amended by adding a new section to read:

"**§ 115D-31.4. Development tier designation.**

(a) Tiers Defined. – A development tier one area is a county whose annual ranking is one of the 40 highest in the State. A development tier two area is a county whose annual ranking is one of the next 40 highest in the State. A development tier three area is a county that is not in a lower-numbered development tier.

(b) Development Factor. – Each year, on or before November 30, the Secretary of Commerce shall assign to each county in the State a development factor that is the sum of the following:

(1) The county's rank in a ranking of counties by average rate of unemployment from lowest to highest, for the most recent 12 months for which data are available.

(2) The county's rank in a ranking of counties by median household income from highest to lowest, for the most recent 12 months for which data are available.

(3) The county's rank in a ranking of counties by percentage growth in population from highest to lowest, for the most recent 36 months for which data are available.

(4) The county's rank in a ranking of counties by adjusted assessed property value per capita as published by the Department of Public Instruction, from highest to lowest, for the most recent taxable year.

(c) Annual Ranking. – After computing the development factor as provided in this section and making the adjustments required in this section, the Secretary of Commerce shall rank all the counties within the State according to their development factor from highest to lowest. The Secretary shall then identify all the areas of the State by development tier and publish this information. A development tier designation is effective only for the calendar year following the designation.

(d) Data. – In measuring rates of unemployment and median household income, the Secretary shall use the latest available data published by a State or federal agency generally recognized as having expertise concerning the data. In measuring population and population growth, the Secretary shall use the most recent estimates of population certified by the State Budget Officer. For the purposes of this section, population statistics do not include people incarcerated in federal or State prisons.

(e) Adjustment for Certain Small Counties. – Regardless of the actual development factor, any county that has a population of less than 12,000 shall automatically be ranked one of the 40 highest counties, any county that has a population of less than 50,000 shall automatically be ranked one of the 80 highest counties, and any county that has a population of less than 50,000 and more than nineteen percent (19%) of its population below the federal poverty level according to the most recent federal decennial census shall automatically be ranked one of the 40 highest counties.

(f) Adjustment for Development Tier One Areas. – Regardless of the actual development factor, a county designated as a development tier one area shall automatically be ranked one of the 40 highest counties until it has been a development tier one area for at least two consecutive years.

(g) Exception for Two-County Industrial Park. – An eligible two-county industrial park has the lower development tier designation of the designations of the two counties in which it is located if it meets all of the following conditions:

(1) It is located in two contiguous counties, one of which has a lower development tier designation than the other.

(2) At least one-third of the park is located in the county with the lower tier designation.

(3) It is owned by the two counties or a joint agency of the counties, is under contractual control of designated agencies working on behalf of both counties, or is subject to a development agreement between both counties and third-party owners.

(4) The county with the lower tier designation contributed at least the lesser of one-half of the cost of developing the park or a proportion of the cost of developing the park equal to the proportion of land in the park located in the county with the lower tier designation.

(h) Exception for Certain Multijurisdictional Industrial Parks. – An eligible industrial park created by interlocal agreement under G.S. 158-7.4 has the lowest development tier designation of the designations of the counties in which it is located if all of the following conditions are satisfied:

(1) The industrial park is located, at one or more sites, in three or more contiguous counties.

(2) At least one of the counties in which the industrial park is located is a development tier one area.

(3) The industrial park is owned by three or more units of local government or a nonprofit corporation owned or controlled by three or more units of local government.

(4) In each county in which the industrial park is located, the park has at least 250 developable acres. For the purposes of this subdivision, 'developable acres' includes acreage that is owned directly by the industrial park or its owners or that is the subject of a development agreement between the industrial park or its owners and a third-party owner.

(5) The total population of all of the counties in which the industrial park is located is less than 200,000.

(6) In each county in which the industrial park is located, at least sixteen and eight-tenths percent (16.8%) of the population was Medicaid eligible for the 2003-2004 fiscal year based on 2003 population estimates."

SECTION 25. G.S. 119-17 is repealed.

SECTION 26.1. Subsection (a) of Section 12 of Part V. of Chapter 908 of the 1983 Session Laws reads as rewritten:

"(a) Any tax levied under this Part is due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.2. Section 39 of Part IX of Chapter 908 of the 1983 Session Laws reads as rewritten:

"Every owner of a business subject to the tax levied by this Part shall, on and after the first day of the calendar month set by the governing body in the resolution levying the tax, collect the occupancy tax provided by this Part. This tax shall be collected as part of the charge for the furnishing of any taxable accommodations. The tax shall be stated and charged separately from the sales records, and shall be paid by the purchaser to the owner of the business as trustee for and on account of the city. The occupancy tax levied under this Part shall be added to the sales price and shall be passed on to the purchaser instead of being borne by the owner of the business. The city tax collector shall design, print, and furnish to all appropriate businesses in the city the necessary forms for filing returns and instructions to ensure the full collection of the tax. Every person liable for the tax imposed pursuant to this Part shall, on or before the ~~15th~~

20th day of each month, prepare and submit a return on the prescribed form stating the total gross receipts derived during the preceding month from rentals upon which the tax is levied. The tax shall be due and payable to the tax collector on a monthly basis.

Any person who fails or refuses to file the return required by this Part shall pay a penalty of ten dollars ($10.00) for each day's omission. In addition, any person who refuses to file the return or pay the tax for a period of 30 days after the time required for filing the return or for paying the tax shall pay a penalty of five percent (5%) of the tax due. An additional penalty of five percent (5%) shall be imposed for each additional month or fraction thereof in which the occupancy tax is not paid.

Any person who willfully attempts in any manner to evade the occupancy tax or who willfully fails to pay the tax or make and file the required return, shall, in addition to all other penalties provided by law, be guilty of a misdemeanor and be punishable by a fine not to exceed one thousand dollars ($1,000), imprisonment not to exceed six months, or both."

SECTION 26.3. Subsection (a) of Section 26 of Part VII of Chapter 908 of the 1983 Session Laws reads as rewritten:

"(a) Any tax levied under this Part is due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.4. Subsection (a) of Section 4 of Chapter 988 of the 1983 Session Laws reads as rewritten:

"(a) Any tax levied under this act is due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.5. Subsection (a) of Section 3 of Chapter 1055 of the 1983 Session Laws reads as rewritten:

"(a) Any tax levied under this act is due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.6. Section 10 of Part IV of Chapter 570 of the 1985 Session Laws reads as rewritten:

"Every owner of a business subject to the tax levied by this Part shall, on and after the first day of the calendar month set by the governing body in the resolution levying the tax, collect the occupancy tax provided by this Part. This tax shall be collected as part of the charge for the furnishing of any taxable accommodations. The tax shall be stated and charged separately from the sales records, and shall be paid by the purchaser to the owner of the business as trustee for and on account of the city. The occupancy tax levied under this Part shall be added to the sales price and shall be passed on to the purchaser instead of being borne by the owner of the business. The city tax collector shall design, print, and furnish to all appropriate businesses in the city the necessary forms for filing returns and instructions to ensure the full collection of the tax. Every person liable for the tax imposed pursuant to this Part shall, on or before the ~~15th~~ 20th day of each month, prepare and submit a return on the prescribed form stating the total gross receipts derived during the preceding month from rentals upon which the tax is levied. The tax shall be due and payable to the tax collector on a monthly basis.

Any person who fails or refuses to file the return required by this Part shall pay a penalty of ten dollars ($10.00) for each day's omission. In addition, any person who refuses to file the return or pay the tax for a period of 30 days after the time required for filing the return or for paying the tax shall pay a penalty of five percent (5%) of the tax due. An additional penalty of five percent (5%) shall be imposed for each additional month or fraction thereof in which the occupancy tax is not paid."

SECTION 26.7. Subsection (a) of Section 4 of Chapter 857 of the 1985 Session Laws reads as rewritten:

"(a) Any tax levied under this act is due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by Onslow County. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.8. Subsection (c) of Section 1 of Chapter 892 of the 1985 Session Laws as amended by Chapter 154 of the 1991 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this act. A tax levied under this act is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this act is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.9. Subsection (c) of Section 1 of Chapter 923 of the 1985 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this act. A tax levied under this act is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals and sales upon which the tax is levied.

A return filed with the county finance officer under this act is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law. "

SECTION 26.10. Subsection (a) of Section 4 of Chapter 929 of the 1985 Session Laws as amended by S.L.1985-929 reads as rewritten:

"(a) Any tax levied under this act is due and payable to the levying jurisdiction in monthly installments on or before the ~~25th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~25th~~ 20th day of each month, prepare and render a return on a form prescribed by the taxing city. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied. A return filed under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.11. Subsection (c) of Section 1 of Chapter 969 of the 1985 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this act. A tax levied under this act is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this act is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.12. Subsection (c) of Section 1 of Chapter 140 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer the tax levied under this act. The tax shall be due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax is collected. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and submit a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals subject to the tax. A return filed with the county finance officer under this act is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.13. Subsection (c) of Section 1 of Chapter 141 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.14. Subsection (c) of Section 1 of Chapter 143 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.15. Subsection (c) of Section 1 of Chapter 170 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The town shall administer a tax levied under this section. A tax levied under this section is due and payable to the town finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the town. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the town finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.16. Subsection (c) of Section 5 of Chapter 172 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this act. A tax levied under this act is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this act is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.17. Subsection (a) of Section 3 of Chapter 188 of the 1987 Session Laws reads as rewritten:

"(a) Any tax levied under this act is due and payable to the county in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.18. Subsection (c) of Section 1 of Title I. of Chaper 460 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The Town shall administer a tax levied under this section. A tax levied under this section is due and payable to the Town revenue collector in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the Town. The return shall state the total gross receipts derived in the preceding month from rentals and sales upon which the tax is levied."

SECTION 26.19. Subsection (c) of Section 1 of Chapter 472 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.20. Subsection (c) of Section 1 of Chapter 484 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.21. Subsection (c) of Section 1 of Chapter 538 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.22. Subsection (c) of Section 1 of Chapter 561 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.23. Subsection (c) Section 1 of Chapter 618 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.24. Subsection (a) of Section 4 of Chapter 647 of the 1987 Session Laws reads as rewritten:

"(a) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.25. Subsection (c) of Section 1 of Chapter 950 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.26. Subsection (c) of Section 1 of Chapter 979 of the 1987 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.27. Subsection (c) of Section 1 of Chapter 173 of the 1989 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.28. Subsection (c) of Section 1 of Chapter 422 of the 1989 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.29. Subsection (e) of Section 8 of Chapter 821 of the 1989 Session Laws reads as rewritten:

"(e) Administration. Mecklenburg County and the City of Charlotte shall determine by agreement which of them will administer and collect each of the taxes levied pursuant to this Part. In the event an agreement cannot be reached, then any tax levied pursuant to this Part shall be administered and collected by Mecklenburg County. The local administrative authority may promulgate additional rules and regulations necessary for the implementation of this Part.

The taxes levied pursuant to this Part are due and payable to the local administrative authority as agent for the taxing entity in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every taxable establishment liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return to the local administrative authority. The local administrative authority shall design, print, and furnish to all taxable establishments the necessary forms for filing returns and instructions to ensure the full collection of the tax.

A return filed with the local administrative authority under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.30. Subsection (c) of Section 1 of Chapter 163 of the 1991 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.31. Subsection (c) of Section 1 of Chapter 230 of the 1991 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.32. Subsection (c) of Section 1 of Chapter 392 of the 1991 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied."

SECTION 26.33. Subsection (c) of Section 5 of Chapter 577 of the 1991 Session Laws reads as rewritten:

"(c) Administration. The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.34. Section 9 of Chapter 594 of the 1991 Session Laws as amended by Section 5 of Chapter 458 of the 1995 Session Laws reads as rewritten:

" Sec. 9. Administration. – The county shall administer and collect the taxes levied pursuant to this act. Wake County may contract with the City of Raleigh to perform these functions.

The taxes levied pursuant to this act are due and payable to the county in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every taxable establishment liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return to the county. The county shall design, print, and furnish on request to all taxable establishments the necessary forms for filing returns and instructions to ensure the full collection of the tax.

Returns filed with the county pursuant to this act are not public records and may not be disclosed except in accordance with G.S. 153A-148.1 or G.S. 160A-208.1."

SECTION 26.35. Subsection (c) of Section 1 of Chapter 453 of the 1993 Session Laws reads as rewritten:

"(c) Administration.

The city shall administer a tax levied under this section. A tax levied under this section is due and payable to the city finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the city. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the city finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.36. Subsection (c) of Section 1 of Chapter 549 of the 1993 Session Laws reads as rewritten:

"(c) Administration.

The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.37. Subsection (c) of Section 1 of Part 1 of Chapter 642 of the 1993 Session Laws reads as rewritten:

"(c) **Administration.** The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.38. Subsection (c) of Section 1 of Chapter 648 of the 1993 Session Laws reads as rewritten:

"(c) Administration. The city shall administer a tax levied under this section. A tax levied under this section is due and payable to the city finance officer in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return on a form prescribed by the city. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the city finance officer under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.39. Subsection (c) of Section 1 of Chapter 695 of the 1993 Session Laws reads as rewritten:

"(c) Administration.

The town shall administer a tax levied under this section. A tax levied under this section is due and payable to the town in monthly installments on or before the ~~fifteenth~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~fifteenth~~ 20th day of each month, prepare and render a return on a form prescribed by the town. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the town under this section is not a public record as defined by G.S. 132-1 and may not be disclosed except as required by law."

SECTION 26.40. Subsection (c) of Section 1 of Chapter 530 of the 1995 Session Laws reads as rewritten:

"(c) **Administration.** The county shall administer a tax levied under this section. A tax levied under this section is due and payable to the county finance officer in monthly installments on or before the ~~15th~~ 20th day of the month following the month in which the tax accrues. Every person, firm, corporation, or association liable for the tax shall, on or before the ~~15th~~ 20th day of each month, prepare and render a return on a form prescribed by the county. The return shall state the total gross receipts derived in the preceding month from rentals upon which the tax is levied.

A return filed with the county finance officer under this section is not a public record and may not be disclosed except in accordance with G.S. 153A-148.1 or G.S. 160A-208.1."

SECTION 27.1. Section 9 of S.L. 2005-294 is repealed.

SECTION 27.2. S.L. 2005-294 is amended by adding a new section 9.1 to read:

" G.S. 105-330.10, as enacted by Section 8 of this act, reads as rewritten:

"**§ 105-330.10. Disposition of interest.**

~~Sixty percent (60%) of the~~ The first month's interest collected on unpaid ~~taxes~~ registration fees pursuant to G.S. 105-330.4 shall be transferred on a monthly basis to the ~~Combined Motor Vehicle and Registration Account created within the Treasurer's Office.~~North Carolina Highway Fund for technology improvements within the Division of Motor Vehicles. ~~The funds in this account shall be used to develop and implement an integrated computer system within the Division of Motor Vehicles that would allow for the combined assessment, billing, and collection of property taxes on motor vehicles and the issuance of registration plates. The Treasurer shall report to the Revenue Laws Study Committee semi-annually with the first report due by April 30, 2006. The report shall contain a detailed description of the amount of moneys transferred to the Account and distributed from the Account.~~"

SECTION 28. The introductory language of Section 6 of S.L. 2006-128 reads as rewritten:

"**SECTION 6.** G.S.153A-155(g) reads as rewritten:"

SECTION 29. Section 33 of S.L. 2006-162 reads as rewritten:

"**SECTION 33.** ~~Section 4~~Sections 4(a) and 4(b) of this act ~~is~~ are effective for taxable years beginning on or after January 1, 2006. Section 13 of this act becomes effective July 1, 2007, and applies to motor fuel transported on or after that date. Sections 14, 15, and 17 of this act become effective January 1, 2007, and apply to motor fuel purchased on or after that date. An exempt card or code will not be valid for sales of motor fuel at the terminal rack on or after January 1, 2007. Section 26 of this act is effective when it becomes law and applies to the estates of decedents dying on or after January 1, 2005. Section 32 of this act becomes effective January 1, 2007. The remainder of this act is effective when it becomes law."

SECTION 30. Section 16 becomes effective January 1, 2010. Section 17 becomes effective July 1, 2007. Section 22 of this act becomes effective October 1, 2007. Section 23 of this act applies to penalties assessed on or after the effective date of this act and to refund requests that have not been finally determined as of the effective date of this act. Section 30 is effective July 1, 2010, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first. The remainder of this act becomes effective when it becomes law.

DRAFT 2007-TDxz-4:
Revenue Laws & Motor Fuels Tax Tech. Changes

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 11, 2007
Introduced by:		**Summary by:**	Heather Fennell
Version:	Draft 2007-TDxz-4		Committee Counsel

***SUMMARY:* This bill makes several technical, clarifying, and administrative changes to the revenue laws and related statutes.**

Sections 1, 7, 9, 23, 24, 27, 28, and 29 are technical changes. Sections 2, 3, 4, 5, 7, 8, 13, 16, and 17 are clarifying changes. Sections 10, 11, 12, 14, 15, 18, 19, 20, 21, 22, 25, and 26 are administrative changes.

BILL ANALYSIS: This bill makes the following technical, clarifying, and administrative changes:

Section	Explanation
1	Deletes an obsolete reference.
2	Clarifies the term "arts organization" in the area of exemptions from the amusement tax.
3	Clarifies the term "arts festivals" in the area of exemptions from the amusement tax.
4	Clarifies the term "community festivals" in the area of exemptions from the amusement tax.
5	Clarifies the amount of excise taxes to be distributed to counties and cities in which the retail sale of alcoholic beverages are authorized to be sold.
6	Clarifies that for the purposes of granting credits for the creation of new jobs, urban progress and agrarian growth zones should be treated separately from other eligible establishments.
7	Substitutes the appropriate reference "apportionable," for the prior reference "business."
8	Clarifies that for the purposes of granting credits for business property placed in service, urban progress and agrarian growth zones should be treated separately from other eligible establishments. Substitutes the appropriate reference "business property," for the prior reference, "machinery and equipment."
9	Substitutes the appropriate reference "out of," for the prior reference "to."
10	Alters the documentation process to reflect the current Department of Revenue practice.
11	Alters the documentation process to reflect the current Department of Revenue practice.
12	Adds ancillary services to items for which the sales tax exemption for State agencies does not apply, in order to reflect the amendments to the changes in taxing telecommunications.
13	Clarifies the dollar amount for filing requirements.

14	Clarifies the payment of tax on purchases of boats and airplanes would not be made on the use tax line of the income tax return.
15	Clarifies the payment of tax on purchases of boats and airplanes would not be made on the use tax line of the income tax return.
16	Clarifies the corresponding property for research and development firms eligible for the 1% privilege tax.
17	Clarifies the exemption for State agencies applies to the privilege tax.
18	Provides that the Secretary of Revenue's authority to summon records also applies to the motor fuel tax statutes. The section makes this change by using the defined term 'tax'. G.S. 105-228.90 defines 'tax' includes all of the State levied taxes. This section would be effective when it becomes law.
19	Clarifies the Department of Revenue's ability to share information with other state agencies and tax officials in other states for the purpose of obtaining data for statistical reports and revenue estimates.
20	Makes a technical change to the statute to require that a civil penalty is payable to the agency that assessed the penalty. In addition to the Department of Revenue, G.S. 105-269.3 provides that the State Highway Patrol, law enforcement officers, and other appropriate personnel in the Department of Crime Control and Public Safety may enforce the motor fuel tax laws. The reorganization of the Division of Motor Vehicles in 2003 moved the State Highway Patrol from DMV to the Department of Crime Control and Public Safety. This substantive change in 2003 necessitated technical, conforming changes to the tax statutes. The wording proposed by this section would eliminate the need for similar conforming changes in the future. This section would be effective when it becomes law.
21	Provides that a fuel alcohol provider and a biodiesel provider need only post a bond to receive a license as a supplier[1] if its annual motor fuel tax liability is at least $2,000. Under current law, to be licensed as a supplier, a fuel alcohol provider or a biodiesel provider must post a bond in an amount that is two times the applicant's average expected monthly tax liability. The amount may not be less than $2,000 and may not be more than $5,000. Under this section, if a fuel alcohol provider or biodiesel provider must post a bond, then the amount would be the same as the current law bond requirement. This section would be effective October 1, 2007.
22	Modifies the defense to imposition of a penalty for failure to obtain a diversion number for motor fuel delivered to a state other than the destination state printed on the shipping document. Under current law, the defense is that the person notified the Secretary of the diversion within seven days after the diversion occurred and timely paid the tax on the diverted fuel.[2] This section removes the seven-day time period by providing that the notification must have occurred prior to the imposition of the penalty. It also removes the requirement that the tax be timely paid if the person assessed with the penalty is the motor fuel transporter because it is not the motor fuel transporter's responsibility to pay the tax.
23	Makes a conforming change to the reference for definitions under the Article.
24	Makes a conforming change by adding definitions needed in the article.

[1] A supplier is defined as any of the following: a position holder or a person who receives motor fuel pursuant to a two-party exchange, a fuel alcohol provider, a biodiesel provider, or a refiner. (G.S. 105-449.60)

[2] The General Assembly established this defense in 2005. (S.L. 2005-435.)

25	Repeals an unnecessary statute. Article 3 of Chapter 119 directs the Commissioner of Agriculture to inspect alternative fuel, motor fuel, and kerosene to protect the public. This statute says that various fuels are subject to inspection. It does not appear to be a necessary statute because the provisions of Article 3 govern what fuel is inspected and what standards the fuel must meet. The terms 'alternative fuel', 'motor fuel', and 'kerosene' are defined terms in Article 3. This section would be effective when it becomes law.
26	Conforms the date an occupancy tax return is due with the date that the occupancy taxes are due.
27	Conforms the language in a session law to language amended by a subsequent session law.
28	Corrects a statutory reference.
29	Conforms the effective date for confidentiality provisions to administrative practices.
30	Section 16 is effective January 1, 2010. Section 17 is effective July 1, 2007. Section 22 of this act becomes effective October 1, 2007. Section 23 of this act applies to penalties assessed on or after the effective date of this act and to refund requests that have not been finally determined as of the effective date of this act. Section 30 is effective July 1, 2010, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first. The remainder of this act is effective when it becomes law.

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APPENDIX A

AUTHORIZING LEGISLATION
ARTICLE 12L OF CHAPTER 120
OF THE
GENERAL STATUTES

ARTICLE 12L

Revenue Laws Study Committee

§ 120-70.105. Creation and membership of the Revenue Laws Study Committee.

(a) Membership. -- The Revenue Laws Study Committee is established. The Committee consists of 16 members as follows:

(1) Eight members appointed by the President Pro Tempore of the Senate; the persons appointed may be members of the Senate or public members.

(2) Eight members appointed by the Speaker of the House of Representatives; the persons appointed may be members of the House of Representatives or public members.

(b) Terms. -- Terms on the Committee are for two years and begin on January 15 of each odd-numbered year, except the terms of the initial members, which begin on appointment. Legislative members may complete a term of service on the Committee even if they do not seek reelection or are not reelected to the General Assembly, but resignation or removal from service in the General Assembly constitutes resignation or removal from service on the Committee.

A member continues to serve until a successor is appointed. A vacancy shall be filled within 30 days by the officer who made the original appointment. (1997-483, s. 14.1; 1998-98, s. 39.)

§ 120-70.106. Purpose and powers of Committee.

(a) The Revenue Laws Study Committee may:

(1) Study the revenue laws of North Carolina and the administration of those laws.

(2) Review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable.

(3) Call upon the Department of Revenue to cooperate with it in the study of the revenue laws.

(4) Report to the General Assembly at the beginning of each regular session concerning its determinations of needed changes in the State's revenue laws.

These powers, which are enumerated by way of illustration, shall be liberally construed to provide for the maximum review by the Committee of all revenue law matters in this State.

(b) The Committee may make interim reports to the General Assembly on matters for which it may report to a regular session of the General Assembly. A report to the General Assembly may contain any legislation needed to implement a recommendation of the Committee. When a recommendation of the Committee, if enacted, would result in an increase or decrease in State revenues, the report of the Committee must include an estimate of the amount of the increase or decrease. (1997-483, s. 14.1.)

§ 120-70.107. Organization of Committee.

(a) The President Pro Tempore of the Senate and the Speaker of the House of Representatives shall each designate a cochair of the Revenue Laws Study Committee. The Committee shall meet upon the joint call of the cochairs.

(b) A quorum of the Committee is nine members. No action may be taken except by a majority vote at a meeting at which a quorum is present. While in the discharge of its official duties, the Committee has the powers of a joint committee under G.S. 120-19 and G.S. 120-19.1 through G.S. 120-19.4.

(c) The Committee shall be funded by the Legislative Services Commission from appropriations made to the General Assembly for that purpose. Members of the Committee receive subsistence and travel expenses as provided in G.S. 120-3.1 and G.S. 138-5. The Committee may contract for consultants or hire employees in accordance with G.S. 120-32.02. Upon approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional staff to assist the Committee in its work. Upon the direction of the Legislative Services Commission, the Supervisors of Clerks of the Senate and of the House of Representatives shall assign clerical staff to the Committee. The expenses for clerical employees shall be borne by the Committee. (1997-483, s. 14.1.)

APPENDIX B

MEETING AGENDAS

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Tuesday, September 5, 2006
Room 544, Legislative Office Building
9:30 a.m.

I. **Welcoming Remarks**

II. **Overview of 2006 Tax Law Changes and Fate of the Revenue Laws Study Committee's Recommendations to the 2006 General Assembly**

Brenna Erford, Fiscal Research

III. **Motor Vehicle Property Tax Collection**

- **Overview of 2005 and 2006 Legislation**
  Martha Walston, Fiscal Research
- **Findings & Recommendations for Determining Valuation of Motor Vehicles for Property Tax Purposes**
  David Baker, Director, Property Tax Division, Department of Revenue
- **Findings & Recommendations for Implementing an Integrated Computer System**
  Stephanie King, Director of Accounting Operations, Department of Transportation
- **Comments**
  - Pete Rodda, Tax Assessor, Forsyth County; North Carolina Tax Assessors Association
  - Paul Meyer, Assistant General Counsel, NCACC
  - John Policastro, NC Automobile Dealers Association

IV. **Corporate Income Tax: Combined Returns**

- **Overview of Issue**
  Cindy Avrette, Research Division
- **Implementation of Current Law**
  - Secretary Norris Tolson, Department of Revenue
  - Greg Radford, Director, Corporate Income Tax Division, Department of Revenue
- **Comments from Interested Parties**

V. **Adjournment**

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr   Rep. Paul Luebke

Tuesday, October 3, 2006
Room 544, Legislative Office Building
9:30 a.m.

I. **Approval of the Minutes from the September 5, 2006, Meeting**

II. **Gift Tax – Overview of the Tax and Alternatives for Simplification**

Canaan Huie, Bill Drafting Division

III. **Hearings and Appeal Process for Disputed Tax Matters**

- **Overview of the Current Process**
  Sabra Faires, Tax Counsel for the Senate
- **Refunds of Tax 'Paid under Protest' and Other Tax Refunds**
  Trina Griffin, Research Division
- **Interested Parties**
    - Jody Joyner, Tax Council, North Carolina Bar Association
    - Jim Ahler, Executive Director, NC Association of Certified Public Accountants
    - Joe Crosby, Council on State Taxation
    - Royce Powell
- **Department of Revenue**
  Linda Millsaps, Assistant Secretary for Tax Administration

IV. **Gross Premiums Tax on Insurance Companies – Simplification of Fire Tax Rate**

- **Review of 2006 Legislation**
    - Cindy Avrette, Research Division
    - Rodney Bizzell, Fiscal Research Division
- **Comments and Concerns**
    - Jim Long, Commissioner of Insurance
    - Joe Stewart, Executive Director, Insurance Federation of North Carolina

V. **Adjournment**

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Thursday, November 16, 2006
Room 544, Legislative Office Building
9:30 a.m.

I. **Approval of the Minutes from the October 3, 2006, Meeting**

II. **Gross Premiums Tax on Insurance Companies – Simplification of Fire Tax Rate**

- **Review of 2006 Legislation**
  - Cindy Avrette, Research Division
  - Rodney Bizzell, Fiscal Research Division
- **Comments and Concerns**
  - Wayne Goodwin, Assistant Commissioner of Insurance
  - Joe Stewart, Executive Director, Insurance Federation of North Carolina

III. **Refunds of Tax "Paid Under Protest": Follow-up and Overview of *Dunn v. State* Case**

Trina Griffin, Research Division

IV. **Property Tax Valuation of Conservation Land**

- **Method of Valuation**
  - Stan Duncan, Tax Assessor, Henderson County
  - Pete Rodda, Tax Assessor, Forsyth County
- **Comments from Interested Parties**
  - Edgar Miller, Director of Government Relations, Conservation Trust for North Carolina
  - Will McDow, Forest Policy Analyst, Environmental Defense

V. **Income Tax Credit for Certain Real Property Donations**

- **History and Review of Tax Credit**
  Dan Ettefagh, Bill Drafting Division
- **Comments from Interested Parties**
  - Richard Rogers, Assistant Secretary for Natural Resources, Department of Environment and Natural Resources
  - Reid Wilson, Executive Director, Conservation Trust for North Carolina
  - Linda Millsaps, Assistant Secretary of Tax Administration, Department of Revenue

VI. **Corporate Income Tax: Process for Estimating Fiscal Impact of Combined Reporting**

Karl Knapp, Director, Tax Research Division, Department of Revenue

VII. **Adjournment**

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Tuesday, December 12, 2006
Room 544, Legislative Office Building
9:30 a.m.

I. **Approval of the Minutes from the November 16, 2006, Meeting**

II. **Gift Tax Simplification**

Canaan Huie, Legislative Drafting Division
Barry Boardman, Fiscal Research Division

III. **IRC Update**

Heather Fennell, Research Division
David Crotts and Barry Boardman, Fiscal Research Division

IV. **Tax Refund Procedure**

Trina Griffin, Research Division

V. **Administrative Appeal Process**

- Trina Griffin, Research Division
- Linda Millsaps, Assistant Secretary of Tax Administration, Department of Revenue

VI. **Mandatory Combined Returns**

Cindy Avrette, Research Division

VII. **Streamlined Sales Tax: Bundled Transactions**

Cindy Avrette, Research Division

VIII. **Motor Fuels Tax Changes**

Cindy Avrette, Research Division

IX. **Adjournment**

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr　　　　　　Rep. Paul Luebke

Tuesday, January 16, 2007
Room 544, Legislative Office Building
9:30 a.m.

I. **Approval of the Minutes from the December 12, 2006, Meeting**

II. **Motor Vehicle Property Tax Changes**
David Baker, Director of the Property Tax Division, Department of Revenue,

III. **Enhance Collection Procedures**
Charlie Helms, Director of the Collections Division, Department of Revenue

IV. **Review of Disputed Tax Matters**
Trina Griffin, Research Division

V. **Combined Returns**
Cindy Avrette, Research Division

VI. **Tax Credit for Real Property Donations**
Dan Ettefagh, Bill Drafting Division

VII. **IRC Update**
Heather Fennell, Research Division
Barry Boardman, Fiscal Research

VIII. **Motor Fuels Tax Changes**
Cindy Avrette, Research Division

IX. **Technical and Administrative Changes**
Heather Fennell, Research Division

X. **Adjournment**

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Tuesday, January 23, 2007
Room 544, Legislative Office Building
9:30 a.m.

I. **Approval of the Minutes from the January 16, 2007, Meeting**

II. **Review of Disputed Tax Matters**

- **A. Trina Griffin, Research Division**
- **B. Comments from Interested Parties**

III. **Legislative Proposals**

1. **Combined Reporting**
   Cindy Avrette, Research Division
2. **Tax Refund Procedure**
   Trina Griffin, Research Division
3. **IRC Update**
   Heather Fennell, Research Division
   David Crotts, Fiscal Research Division
4. **Tax Credit for Real Property Donations**
   Dan Ettefagh, Bill Drafting Division
   Barry Boardman, Fiscal Research Division
5. **Streamlined Sales Tax Changes**
   Andy Sabol, Department of Revenue
   Cindy Avrette, Research Division
6. **Gift Tax Simplification**
   Canaan Huie, Bill Drafting Division
   Barry Boardman, Fiscal Research Division
7. **Enhance Collection Procedures**
   Cindy Avrette, Research Division
8. **Gross Premiums Tax**
   Cindy Avrette, Research Division
   Rodney Bizzell, Fiscal Research Division
9. **Technical and Administrative Changes**
   Heather Fennell, Research Division

IV. **Approval of Final Report**

V. **Adjournment**

APPENDIX C

DISPOSITION OF COMMITTEE'S RECOMMENDATIONS TO THE 2006 SESSION OF THE 2005 GENERAL ASSEMBLY

SHORT TITLE	SENATE SPONSORS	HOUSE SPONSORS	BILL #	FINAL STATUS*
Additional Personal Income Tax Filing Option	**Webster**		SB 1552	**Enacted SL 2006-66, Sec. 24.11 (Budget Bill)**
Amend Taxation of Logging Machinery		**Wainwright, Church, McComas, Underhill**	HB 1938	**Enacted SL 2006-19**
Delinquent Property Tax/Inventory/Study	**Hartsell**		SB 1451	**Enacted* SL 2006-106**
Electricity Franchise Tax Distribution	**Hoyle**		SB 343	Not enacted
Expansion of Royalty Reporting Option		**Luebke**	HB 2048	**Enacted SL 2006-66, Sec. 24A.3 (Budget Bill)**
Franchise Tax Base Calculation	**Hartsell**		SB 1283	**Enacted SL 2006-95**
Franchise Tax Loophole Closing		**Luebke**	HB 1962	**Enacted SL 2006-66, Sec. 24A.2 (Budget Bill)**
IRC Update		**Wainwright, Luebke, Carney, Wilkins**	HB 1892	**Enacted SL 2006-18**
Property Tax Changes		**Brubaker**	HB 2097	**Enacted SL 2006-30**
Revenue Laws Tech. & Motor Fuel Tax Changes		**Luebke**	HB 1963	**Enacted SL 2006-162**
S Corp Income Tax Adjustments		**Wilkins**	HB 1898	**Enacted SL 2006-17**
Simplify Fire Tax Rate/Other Tax Changes		**Wainwright, Luebke, Church, Hill**	HB 1891	**Enacted* SL 2006-196**
SSTA Sales Tax Defn/Sales Tax Payments		**Hill**	HB 1915	**Enacted SL 2006-33**
Video Service Competition Act		**Carney, Luebke, McComas Wainwright**	HB 2047	**Enacted SL 2006-151**

[*] Bills were modified prior to enactment.

APPENDIX D

TESTIMONY
of
JOSEPH R. CROSBY
LEGISLATIVE DIRECTOR
COUNCIL ON STATE TAXATION
(COST)

FAIR, EFFICIENT AND CUSTOMER-FOCUSED TAX ADMINISTRATION

OCTOBER 3, 2006

APPENDIX E

TAX APPEALS PROPOSAL
TRINA GRIFFIN
RESEARCH DIVISION
DISTRIBUTED JANUARY 16, 2007
PRESENTED JANUARY 23, 2007

Proposal for Review of Disputed Tax Matters

Revenue Laws Study Committee
January 16, 2007

A fair, efficient, and transparent tax appeals process is a critical element of the effective administration of a State's tax system. The Revenue Laws Study Committee, in its recent review of this issue, has heard from the Council on State Taxation (COST), which had the opportunity to express concerns about the current system and to make recommendations for improvement. The Committee also heard from the Department of Revenue, which had the opportunity to explain the current system, to offer counterpoints regarding the system's strengths, and to suggest its own recommendations.

Issues

In light of the testimony presented at prior meetings, the following issues have been identified as the areas of most concern that impact the appeals process:

1. **Independent forum for review.**
   COST position: Tax appeals cases should be heard by the North Carolina Business Court or some other body outside the Department of Revenue to ensure an impartial hearing. Also, the reviewing forum should have the ability to develop tax expertise.
   Department position: No systemic changes to the current administrative system are necessary because the Department provides an impartial hearing by an independent hearings officer, and the Tax Review Board provides an impartial review. Instead, clarifying statutory changes are needed to more accurately describe the existing administrative practice.
2. **Payment of tax to obtain judicial review of a disputed tax matter.**
   COST position: The requirement that a taxpayer pay a proposed tax liability in order to obtain an independent hearing in a neutral forum outside the Department should be eliminated.
   Department position: The payment requirement should be maintained because without it, the Department's ability to collect would be compromised and litigation would substantially increase.
3. **Length of time to object to a notice of proposed assessment.**
   COST position: Taxpayers should be given at least 60, but ideally 90, days to request a hearing on a notice of a proposed assessment.
   Department position: The time period should remain 30 days because the extension of time delays collection and potentially compromises the State's likelihood of collection.

Principles

Based on the above-stated issues, the following principles have been identified as a guideline for making improvements to the current system:

- **Simplicity** – An effective tax appeals system should be easily understandable by taxpayers and practitioners, produce a resolution in a timely manner, and apply the same procedures for assessments and refunds.

- **Fairness** – An effective tax appeals system should afford all taxpayers, regardless of their resources, the opportunity to have a hearing before an independent arbiter with expertise in the subject matter without first having to pay the disputed liability.
- **Emphasis on Informal Resolution** – An effective tax appeals system should encourage the informal resolution of tax controversies, without litigation, in a manner that will enhance voluntary compliance and public confidence in the integrity of the system.

Proposed Changes & Application of Principles

Applying these principles to the identified issues, the proposal makes the following changes to the law:

1. **Independent forum for review.** – The proposal establishes the Office of Administrative Hearings (OAH) as the independent forum for the review of contested tax matters. Under current law, administrative review of a disputed tax matter involves a hearing before a hearings officer within the Department followed by an appeal to the Tax Review Board. The proposal modifies the current law by requiring an initial, informal review process within the Department. A taxpayer who is not satisfied with the outcome of the informal process must commence a contested case with the OAH. OAH would issue a final decision, reserving constitutional questions for determination by the Business and Tax Court. If OAH issues a final decision in the case, either party would have the option of seeking judicial review of the decision in the Business and Tax Court. Alternatively, OAH may transfer the case to Business and Tax Court if the only issue involves the constitutionality of a statute.

   This proposed change addresses at least two of the above-stated principles. First, it promotes informal resolution by requiring an informal review and conference with the Department, which is designed to encourage settlement without litigation. It also addresses the fairness principle by establishing OAH as the independent arbiter of disputed tax matters.

2. **Payment of tax to obtain judicial review of a disputed tax matter.** – The proposal provides that a taxpayer does not have to pay a proposed tax liability in order to obtain an independent hearing on the merits. However, a taxpayer would be required to pay the tax in order to obtain judicial review of a decision resulting from that independent hearing. Therefore, a taxpayer would not have to pay the tax in order to have an independent hearing at OAH, but would have to pay the tax in order to appeal an ALJ's final decision to Business and Tax Court. If, however, OAH determines the case involves a question only about the constitutionality of a statute, then OAH would not render a decision on the merits and would transfer the case to Business and Tax Court. No payment of tax would be required if the case is transferred based on OAH's lack of jurisdiction because the taxpayer has not yet received an independent hearing on the merits. However, a taxpayer seeking judicial review of the Business and Tax Court's decision on the constitutional matter would be required to pay the tax to appeal to the Court of Appeals.

   This proposed change addresses two of the above-stated principles. First, it promotes fairness by providing all taxpayers, regardless of their resources, with the same avenues for recourse when challenging a tax dispute. Moreover, by not requiring payment of the tax until after a taxpayer has had the opportunity to have an expeditious and impartial hearing, the proposal strikes the appropriate balance between protecting the fiscal stability of the State and protecting the rights of the taxpayer to be heard. Second, the proposed change promotes simplicity by establishing a consistent method for determining when a taxpayer must pay the tax during the tax appeals process, regardless of tax type or whether the dispute involves an assessment or a refund.

3. **Elimination of Tax Review Board. –** The proposal eliminates the Tax Review Board. Under this proposal, the role of the Tax Review Board is no longer needed because OAH would be the independent arbiter of disputed tax matters and the jurisdiction of the Business and Tax Court would include the review of tax cases. This change promotes simplicity and efficiency by eliminating an unnecessary step in the administrative review process.

4. **Expansion of Business Court jurisdiction.** – Currently, the North Carolina Business Court only handles cases involving complex and significant issues of corporate and commercial law, which are assigned by the Chief Justice of the North Carolina Supreme Court and designated "Complex Business Cases." This proposal contemplates adding all tax cases to the jurisdiction of the Business Court, which would be renamed the "North Carolina Business and Tax Court." This change addresses the fairness principle by providing both taxpayers and the State alike with a specialized forum for tax cases where it is anticipated that the court will develop expertise in this often complex area of the law.

5. **Length of time to object to a proposed assessment.** – The proposal adopts a 45-day time period for taxpayers to request an informal review of a notice of a proposed assessment, which reflects a balance between the positions of the taxpayer advocacy group COST and the Department of Revenue. This compromise applies the fairness principle by providing taxpayers with 15 additional days while not delaying unreasonably the Department's collection efforts.

APPENDIX F

LETTERS OF SUPPORT
from
MEMBERS OF THE TAX COUNCIL OF THE
NORTH CAROLINA BAR ASSOCIATION
in re
REVIEW OF DISPUTED TAX MATTERS
("THE PROPOSAL")
JANUARY, 2007

APPENDIX G

S. L. 2005-294 (HB 1779), s. 13
AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM.

as amended by

S. L. 2006-259 (SB 1523), s. 31.5
AN ACT TO MAKE TECHNICAL CORRECTIONS AND CONFORMING CHANGES TO THE GENERAL STATUTES AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, AND TO MAKE VARIOUS OTHER CHANGES TO THE GENERAL STATUTES AND SESSION LAWS.

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2005

SESSION LAW 2005-294
HOUSE BILL 1779

AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-330 is amended by adding two new subdivisions to read:

"(4) Collecting authority. The Division of Motor Vehicles or an agent contracting with the Division of Motor Vehicles.

(5) Municipal corporation. Defined in G.S. 105-273(11)."

SECTION 2. G.S. 105-330.2 reads as rewritten:

"**§ 105-330.2. Appraisal, ownership, and situs.**

(a) Date Determined. – The value of a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(1) (registered vehicles) shall be determined as of January 1 of the year the taxes are due. If the value of a new motor vehicle cannot be determined as of that date, the value of that vehicle shall be determined for that year as of the date that model vehicle is first offered for sale at retail in this State.

The ownership, situs, and taxability of a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(1) (registered vehicles) shall be determined annually as of the day on which a new registration is applied for or the day on which the current vehicle registration is renewed, regardless of whether the registration is renewed after it has expired.

The value of a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(2) (unregistered vehicles) shall be determined as of January 1 of the year in which the motor vehicle is required to be listed pursuant to G.S. 105-330.3(a)(2). The ownership, situs, and taxability of a classified motor vehicle listed or discovered pursuant to G.S. 105-330.3(a)(2) (unregistered vehicles) shall be determined as of January 1 of the year in which the motor vehicle is required to be listed.

(b) Value; Appeal. – A classified motor vehicle shall be appraised by the assessor at its true value in money as prescribed by G.S. 105-283. The Property Tax Division of the Department of Revenue shall annually adopt a schedule of values, standards, and rules to be used in the valuation of motor vehicles to ensure equitable statewide valuations, taking into account local market conditions and allowing adjustments for mileage and the condition of the vehicles. The owner of a classified motor vehicle may appeal the appraised value of the vehicle in the manner provided by G.S. 105-312(d) for appeals in the case of discovered property and may appeal the situs or taxability of the vehicle in the manner provided by G.S. 105-381. The owner of a classified motor vehicle must file an appeal of appraised value with the assessor ~~within 30 days after the date of the tax notice prepared pursuant to G.S. 105-330.5.~~before the taxes become delinquent pursuant to G.S. 105-330.4. Notwithstanding G.S. 105-312(d), an owner who appeals the appraised value of a classified motor vehicle shall pay the tax on the vehicle when due, subject to a full or partial refund if the appeal is decided in the owner's favor.

(c) Administration. – The Department of Revenue, acting through the Property Tax Division, and the Department of Transportation, acting through the Division of Motor Vehicles, shall enter into a memorandum of understanding concerning the vehicle identification information, name and address of the owner, and other information that will be required on the motor vehicle registration forms to implement the tax listing and collection provisions of this Article. The memorandum of understanding shall also include a procedure for the administration of the listing, appraisal, and assessment of classified motor vehicles."

SECTION 3. G.S. 105-330.4(a) reads as rewritten:

"(a) Taxes on a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(2) ~~shall be~~are due on September 1 following the date by which the vehicle was required to be listed. Taxes on a classified motor vehicle listed pursuant to G.S. 105-330.3(a)(1) ~~shall be~~are due each year on the ~~following dates:~~

~~(1) For a vehicle registered under the staggered system, taxes shall be due on the first day of the fourth month following the date the registration expires or on the first day of the fourth month following the last day of the month in which the new registration is applied for.~~date a new registration is applied for or the fifteenth day of the month following the month in which the registration renewal sticker expired pursuant to G.S. 20-66(g).

~~(2) For a vehicle newly registered under the annual system, taxes shall be due on the first day of the fourth month following the date the new registration is applied for. For a vehicle whose registration is renewed under the annual system, taxes shall be due on May 1 following the date the registration expired.~~"

SECTION 4. G.S. 105-330.4(b) reads as rewritten:

"(b) Subject to the provisions of G.S. 105-395.1, interest on unpaid taxes on classified motor vehicles listed pursuant to G.S. 105-330.3(a)(1) accrues at the rate of ~~two percent (2%)~~ five percent (5%) for the first month following the date the taxes were due and three-fourths percent (3/4 %) for each month thereafter until the taxes are paid, unless the ~~tax~~ notice required by G.S. 105-330.5 is prepared after the date the taxes are due. In that circumstance, the interest accrues beginning the second month following the date of the notice until the taxes are paid. Subject to the provisions of G.S. 105-395.1, interest on delinquent taxes on classified motor vehicles listed pursuant to G.S. 105-330.3(a)(2) accrues as provided in G.S. 105-360(a) and discounts shall be allowed as provided in G.S. 105-360(c)."

SECTION 5. G.S. 105-330.4(b), as amended by Section 4 of this act, reads as rewritten:

"(b) Subject to the provisions of G.S. 105-395.1, interest on unpaid taxes and registration fees on classified motor vehicles listed pursuant to G.S. 105-330.3(a)(1) accrues at the rate of five percent (5%) for the ~~first month~~remainder of the month following the ~~date~~ month in which the registration renewal sticker expired pursuant to G.S. 20-66(g).~~the taxes were due and~~ Interest accrues at the rate of three-fourths percent (3/4 %) for each month thereafter until the taxes and fees are paid, unless the notice required by G.S. 105-330.5 is prepared after the date the taxes and fees are due. In that circumstance, the interest accrues beginning the second month following the date of the notice until the taxes and fees are paid. Subject to the provisions of G.S. 105-395.1, interest on delinquent taxes on classified motor vehicles listed pursuant to G.S. 105-330.3(a)(2) accrues as provided in G.S. 105-360(a) and discounts shall be allowed as provided in G.S. 105-360(c)."

SECTION 6. G.S. 105-330.5 reads as rewritten:

"**§ 105-330.5. Listing and collecting procedures.**

(a) For classified motor vehicles listed pursuant to G.S. 105-330.3(a)(1), upon receiving the registration lists from the Division of Motor Vehicles each month, the ~~assessor~~ Property Tax Division of the Department of Revenue shall prepare a combined tax and registration notice for each ~~vehicle; the~~vehicle. The combined tax and registration notice shall contain all ~~county, municipal, and special district~~county and municipal corporation taxes and fees due on the motor ~~vehicle.~~vehicle as computed by the assessor in the county of registration. In computing the taxes, the assessor shall appraise the motor vehicle in accordance with G.S. 105-330.2 and shall use the tax rates of the various taxing units in effect on the first day of the month in which the current vehicle registration ~~expired~~ expires or the new registration ~~was~~ is applied for. This procedure shall constitute the listing and assessment of each classified motor vehicle for taxation. The combined tax and registration notice shall contain:

(1) The date of the combined tax and registration notice.
(2) The appraised value of the motor vehicle.
(3) The tax rate of the taxing units.
(4) A statement that the appraised value of the motor vehicle may be appealed to the assessor ~~within 30 days after the date of the notice.~~before the taxes and fees become delinquent.
(5) The registration fee imposed by the Division of Motor Vehicles and any other information required by the Division of Motor Vehicles to comply with the provisions of Chapter 20 of the General Statutes.

(a1) When a new registration is obtained for a vehicle registered under the annual system in a month other than December, the ~~assessor~~ taxes shall ~~prorate the taxes due~~be prorated for the remainder of the calendar year. The amount of prorated taxes due is the product of the proration fraction and the taxes computed according to subsection (a). The numerator of the proration fraction is the number of full months remaining in the calendar year following the date the registration is applied for and the denominator of the fraction is 12.

(b) When the combined tax and registration notice required by subsection (a) is prepared, the ~~county tax collector~~Property Tax Division of the Department of Revenue or a third-party contractor shall mail a copy of the notice, with appropriate instructions for payment, to the motor vehicle owner. The Department shall establish a fee equal to the actual cost of printing and sending the notice. The Department may receive a fee for each notice generated for a vehicle registered in a county or municipal corporation from the taxes and fees remitted to the county or municipal corporation in which the vehicle is registered. The collecting authority is responsible for collecting county and municipal taxes and fees assessed under this Article and ~~The county~~ may retain ~~the actual cost of~~a fee for collecting ~~municipal and special district taxes~~these taxes and fees. ~~collected pursuant to this Article,~~ The fee retained by the collecting authority ~~not to exceed one and one-half percent (1 1/2%) of the amount of taxes collected.~~shall be an amount equal to at least one-third of the compensation paid for registration renewals conducted by contract agents under G.S. 20-63(h). The ~~county finance officer~~Property Tax Division shall establish procedures to ensure that tax payments and fees received pursuant to this Article and Chapter 20 of the General Statutes are properly accounted for and taxes and fees due other taxing units and the Division of Motor Vehicles are remitted ~~to the units to which they are due~~ at least once each month. Each ~~month, a county~~collecting authority shall provide a weekly financial report containing ~~reasonable~~ information required by the Property Tax Division to the ~~municipalities and special districts located in it~~taxing units and Division of Motor Vehicles to enable them to account for ~~the tax~~ payments ~~remitted tothem.~~received.

(b1) Repealed by Session Laws 1995, c. 329, s. 2.

(c) For classified motor vehicles listed pursuant to G.S. 105-330.3(a)(2), the assessor shall appraise each vehicle in accordance with G.S. 105-330.2. The assessor shall prepare a tax notice for each vehicle before September 1 following the January 31 listing date; the tax notice shall include all county and special district taxes due on the motor vehicle. In computing the taxes, the assessor shall use the tax rates of the taxing units in effect for the fiscal year that begins on July 1 following the January 31 listing date. Municipalities shall list, assess, and tax classified motor vehicles listed pursuant to G.S. 105-330.3(a)(2) as provided in G.S. 105-326, 105-327, and 105-328 and shall send tax notices as provided in this section.

(d) The county shall include taxes on classified motor vehicles listed pursuant to G.S. 105-330.3(a)(1) in the tax levy for the fiscal year in which the taxes become due and shall charge the taxes to the tax collector for that year, unless the tax notice required by subsection (a) is prepared after the date the taxes are due. If that occurs, the county shall include the taxes from that notice in the tax levy for the current fiscal year and shall charge the taxes to the tax collector for that year."

SECTION 7. G.S. 105-330.7 is repealed.

SECTION 8. Article 22A of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-330.10. Disposition of interest.**

Sixty percent (60%) of the interest collected on unpaid taxes pursuant to G.S. 105-330.4 shall be transferred on a monthly basis to the Combined Motor Vehicle and Registration Account created within the Treasurer's Office. The North Carolina Association of County Commissioners shall direct the Treasurer to distribute the funds in the Account to the Division of Motor Vehicles for the purpose of developing and implementing an integrated computer system within the Division of Motor Vehicles that would allow for the combined assessment, billing, and collection of property taxes on motor vehicles and the issuance of registration plates. The Treasurer shall report to the Revenue Laws Study Committee semiannually with the first report due by April 30, 2006. The report shall contain a detailed description of the amount of moneys transferred to the Account and distributed from the Account."

SECTION 9. G.S. 105-330.10, as enacted by Section 8 of this act, reads as rewritten:

"**§ 105-330.10. Disposition of interest.**

~~Sixty percent (60%) of the~~ The interest collected on unpaid ~~taxes~~ registration fees pursuant to G.S. 105-330.4 shall be transferred on a monthly basis to the ~~Combined Motor Vehicle and Registration Account created within the Treasurer's Office.~~North Carolina Highway Fund for technology improvements within the Division of Motor Vehicles. ~~The funds in this account shall be used to develop and implement an integrated computer system within the Division of Motor Vehicles that would allow for the combined assessment, billing, and collection of property taxes on motor vehicles and the issuance of registration plates. The Treasurer shall report to the Revenue Laws Study Committee semi-annually with the first report due by April 30, 2006. The report shall contain a detailed description of the amount of moneys transferred to the Account and distributed from the Account.~~"

SECTION 10. G.S. 20-50.3 is repealed.

SECTION 11. G.S. 20-50.4 reads as rewritten:

"**§ 20-50.4. Division to refuse to register vehicles on which county and municipal taxes and fees are ~~delinquent~~ not paid and when there is a failure to meet court-ordered child support obligations.**

(a) ~~Delinquent~~ Property Taxes Paid with Registration.~~Property Taxes.~~ – ~~Upon receiving the list of motor vehicle owners and motor vehicles sent by county tax collectors pursuant to G.S. 105-330.7, the~~The Division shall refuse to register ~~for the owner named in the list any vehicle identified in the list until either the vehicle owner presents the Division with a paid tax receipt identifying the vehicle for which registration was refused or the county certifies to the Division that the tax has been paid. The Division shall not refuse to register a vehicle for a person, not named in the list, to whom the vehicle has been transferred in good faith. Where a motor vehicle owner named in the list has transferred the registration plates from the motor vehicle identified in the list to another motor vehicle pursuant to G.S. 20-64 during the first vehicle's tax year, the Division shall refuse registration of the second vehicle until the vehicle owner presents the Division with a paid tax receipt identifying the vehicle from which the plates were transferred or the county certifies to the Division that the tax has been paid. The certification must be in the form and contain the information required by the Division.~~a vehicle on which county and municipal taxes and fees have not been paid.

(b) Delinquent Child Support Obligations. – Upon receiving a report from a child support enforcement agency that sanctions pursuant to G.S. 110-142.2(a)(3) have been imposed, the Division shall refuse to register a vehicle for the owner named in the report until the Division receives certification pursuant to G.S. 110-142.2 that the payments are no longer considered delinquent."

SECTION 12. The Property Tax Division within the Department of Revenue and the Division of Motor Vehicles within the Department of Transportation shall jointly study and develop a plan for determining the method of valuation of motor vehicles to be taxed and for implementing an integrated computer system needed to combine the registration renewal and property tax collection for motor vehicles in the State. The Divisions shall consult with representatives from the North Carolina Association of County Commissioners, the North Carolina League of Municipalities, the North Carolina Association of Assessing Officers, the North Carolina Automobile Dealers Association, the North Carolina Independent Automobile Dealers Association, and the North Carolina Tax Collectors Association. The Divisions shall submit a report of its findings and recommendations to the Revenue Laws Study Committee, the Joint Legislative Transportation Oversight Committee, and the Fiscal Research Division by April 30, 2006.

SECTION 13. Sections 4 and 8 of this act become effective January 1, 2006. Sections 1, 2, 3, 5, 6, 7, 9, 10, and 11 of this act become effective July 1, 2009, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first. Sections 12 and 13 of this act are effective when they become law. Nothing in this act shall require the General Assembly to appropriate funds to implement it for the biennium ending June 30, 2007.

In the General Assembly read three times and ratified this the 11th day of August, 2005.

s/ Beverly E. Perdue
President of the Senate

s/ James B. Black
Speaker of the House of Representatives

s/ Michael F. Easley
Governor

Approved 2:57 p.m. this 22^{nd} day of August, 2005

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2005

SESSION LAW 2006-259
SENATE BILL 1523

AN ACT TO MAKE TECHNICAL CORRECTIONS AND CONFORMING CHANGES TO THE GENERAL STATUTES AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, AND TO MAKE VARIOUS OTHER CHANGES TO THE GENERAL STATUTES AND SESSION LAWS.

The General Assembly of North Carolina enacts:

…

SECTION 31.5. Section 13 of S.L. 2005-294 reads as rewritten:

"**SECTION 13.** Sections 4 and 8 of this act become effective January 1, 2006. Sections 1, 2, 3, 5, 6, 7, 9, 10, and 11 of this act become effective July 1, ~~2009,~~ 2010, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first. Sections 12 and 13 of this act are effective when they become law. Nothing in this act shall require the General Assembly to appropriate funds to implement it for the biennium ending June 30, 2007."

…

PART III. EFFECTIVE DATE

SECTION 56. Except as otherwise provided, this act is effective when it becomes law.

In the General Assembly read three times and ratified this the 27th day of July, 2006.

s/ Beverly E. Perdue
President of the Senate

s/ James B. Black
Speaker of the House of Representatives

s/ Michael F. Easley
Governor

Approved 7:02 p.m. this 23rd day of August, 2006

APPENDIX H

PRESENTATION
by
EDGAR MILLER
CONSERVATION TRUST FOR NC
and
WILL McDOW
ENVIRONMENTAL DEFENSE

IMPROVING PROPERTY TAX INCENTIVES FOR VOLUNTARY LAND CONSERVATION

NOVEMBER 16, 2006

APPENDIX I

REPORT
by
STAN C. DUNCAN
HENDERSON COUNTY TAX ASSESSOR

IMPACT OF CONSERVATION EASEMENTS ON LOCAL PROPERTY TAX APPRAISALS AND ASSESSMENTS

NOVEMBER 16, 2006

APPENDIX J

REPORT
by
PETE RODDA
FORSYTH COUNTY TAX ASSESSOR

EXEMPTION FACTS FOR THE REVENUE LAWS STUDY COMMITTEE

NOVEMBER 16, 2006

APPENDIX K

PRESENTATION
by
ENVIRONMENTAL DEFENSE

LEGISLATIVE OPTIONS TO UPDATE THE PRESENT USE VALUE PROGRAM

NOVEMBER 16, 2006

APPENDIX L

OVERVIEW
Dunn v. State of North Carolina
AND ITS IMPACT ON THE PROTEST RULE

TRINA GRIFFIN
RESEARCH DIVISION

NOVEMBER 16, 2006

Tax Exemption for In-State Municipal Bonds: An Overview of *Dunn v. State of North Carolina* and its Impact on the Protest Rule

Prepared by Trina Griffin
Revenue Laws Study Committee
November 16, 2006

Summary

The Dunn case is important for two reasons:

1. Substantively – If North Carolina's tax treatment of interest income earned on non-State versus State-issued obligations is found unconstitutional, it could have a profound impact on the municipal bond market, both locally and nationwide, it could result in a significant revenue loss if the State is required to issue refunds to holders of out-of-state bonds, and it could foreshadow future litigation over similar preferential tax exemptions for in-state activity.
2. Procedurally - Its interpretation of G.S. 105-267 greatly expands the protest rule beyond the scope of *Bailey II*, which has the potential to put the State in a precarious position with regard to its ability to budget for refunds in the future, and fails to provide clear guidance to taxpayers about the procedural requirements that must be met to preserve a refund claim.

Nature of Municipal Bonds

Municipal bonds are debt obligations issued by states, cities, counties and other governmental entities to raise money to build schools, highways, hospitals and sewer systems, as well as many other projects for the public good. By purchasing a municipal bond, the purchaser is lending money to an issuer who promises to pay a specified amount of interest and return the principal on a specific maturity date.

Tax Treatment of Municipal Bond Income

- Exempt from federal income tax.
- Over 40 states provide a tax exemption on obligations issued by the home state while levying a tax on interest income derived from obligations issued by other states.
- 9 states do not tax interest derived from out-of-state bonds.

Legal Challenges

There are three ongoing cases, in Kentucky, Arizona, and North Carolina, challenging state tax exemptions for interest income derived from home-state bond obligations.

Kentucky

Davis v. Department of Revenue, *193 S.W.3d 557 (Ky. App. 2006)*

In *Davis*, the Kentucky Court of Appeals held that it is unconstitutional for the state to tax interest received by its residents earned on bonds issued by other states and their political subdivisions. Specifically, the court found that the taxation scheme discriminates against interstate commerce because it affords more favorable taxation treatment to in-state bonds than it does to extraterritorially-issued bonds. The Kentucky Supreme Court declined to hear the case, and the state has filed a petition for review with the United States Supreme Court.

North Carolina

Dunn v. Department of Revenue, COA05-1178 (October 2006)

In *Dunn v. Department of Revenue*, the plaintiffs are individual taxpayers who paid tax on income earned on out-of-state obligations and filed a demand for a refund for tax years 2001 and 2002. The Superior Court certified the case as a class action with class membership consisting of all persons and entities who paid the tax at issue "from October 29, 2000 through the date of final judgment." The State appealed the order certifying the class, and on October 17, 2006, the North Carolina Court of Appeals upheld the order. The court did not reach the merits. The State has appealed the decision to the North Carolina Supreme Court.

Possible Ramifications of Litigation

1. *Creation of competitive disadvantage for some states* .- If the U.S. Supreme Court declines to hear the Kentucky case, the short-term impact would be that states with decisions striking down the exemption would be at a competitive disadvantage in the municipal bond market compared to states whose courts have either not issued an opinion on the matter or have found the exemption constitutional.

If the Kentucky decision is made the law of the land, the potential ramifications could include:

2. *Changing the tax treatment of municipal bonds.* – North Carolina, along with many other states, would be faced with two options: make all bonds exempt from tax, or tax the interest on all bonds.

3. *Revenue loss*. – The State would be required to issue refunds to bondholders who had been previously taxed.

4. *Impact on municipal bond market*. – The decision would tend to drive the yields on all states' bonds to the same level because, without an incentive to invest in bonds from one's own state, investors would be indifferent to which bonds they owned. States would likely have to raise their rates to shop around for customers. This ruling could create a national market in municipal bonds, rather than the fragmented, regional one we have now. Finally, some industry observers have speculated that taxing all municipal bonds at the state level would increase the cost of borrowing.

5. *Challenges to other taxation schemes favoring in-state activity*. – The decision would likely lead to litigation over whether other tax schemes offering preferential tax treatment for in-state activity are also unconstitutional. For example, numerous states confer a tax-exemption or deduction to residents who participate in the state's Section 529 college savings plan, but not for investments in another state's Section 529 plan. While the issues may very well be distinguishable and the result may not be the same, there may still be legal challenges to face.

Dunn and the Protest Rule

The recent North Carolina Court of Appeals decision further undercuts, and virtually obliterates, the protest rule and greatly expands the scope of *Bailey II* in unprecedented ways.

- The court certified a class consisting of members who have not paid the tax in question under the particular statute being challenged.

- The court included as members of the class all persons or entities who have paid the tax on interest from out-of-state obligations from October 29, 2000 through the date of final judgment, regardless of whether they filed a protest.

  ➔"…[O]nce the State is put on notice that a tax provision is being challenged, not every taxpayer seeking restitution under G.S. 105-267 must comply with the statute. . .Once notice is received, the burden is on the State to determine its potential exposure and to plan accordingly." This holding seems to suggest that notice of a tax being challenged, without additional qualification, is all that is required regardless of the burden on the State to determine its fiscal liability.

- The court adopted, and further muddied, an already unclear and problematic "post-facto" test.

<u>Points to Consider</u>

1. Does the law as currently written and interpreted by our state Supreme Court serve the purpose for which it was intended?
2. If not, does the statute need to be either repealed or rewritten to effectuate its purpose? If so, how?

<u>Conclusion</u>

The *Bailey II* case has made North Carolina susceptible to being targeted for additional class action litigation, like the *Dunn* case. Now, the *Dunn* case has further complicated an already muddy area of the law and has put the State in a precarious position with regard to its ability to properly plan for its potential liability for tax refunds in the future. Consequently, this Committee may want to consider clarifying the policy with regard to how constitutional taxation claims should be handled and what, if any, procedural requirements a taxpayer should meet in order to be eligible for relief.