



# SENATE BILL 394: Lower Tax Rates for a Stronger NC Economy

2013-2014 General Assembly

**Committee:** Senate Ref to Finance. If fav, re-ref to Appropriations/Base Budget **Date:** April 3, 2013  
**Introduced by:** Sens. Clodfelter, Hartsell, Jenkins, Meredith **Prepared by:** Finance Team  
**Analysis of:** PCS to Second Edition  
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**SUMMARY:** *Senate Bill 394 makes substantial changes to the tax code by lowering all of the major rates and by broadening the base. The PCS makes several changes to the bill, but the primary changes include addressing the local distribution of revenues and moving to a single sales factor apportionment formula for corporate income and franchise tax.*

**BILL ANALYSIS:**

**Part I. Statement of Findings and Purpose**

These statements explain the reason tax reform is needed and establish economic development as the primary goal of the legislation. The goal is accomplished by applying the basic broad base/low rate principle of tax policy to lower all major tax rates.

**Part II. Individual Income Tax**

This Part simplifies the calculation and administration of the individual income tax laws. It significantly broadens the base and lowers the rate. Currently, there are three income tax brackets – 6%, 7%, and 7.75%. Under the bill, there would be a flat 6% tax rate on taxable income.<sup>1</sup> It broadens the base by eliminating most of the credits and deductions allowed under current law. It substitutes a zero percent tax bracket in place of personal exemptions and itemized/standard deductions. The only credits against the tax imposed are a personal credit, a credit for children, and a credit for charitable contributions. The key changes may be found in subsections (e) and (g) of this Part.

Bill Section	Brief Description
Section 2(a)	This Part reorganizes the individual income tax Article. In so doing, this subsection recodifies several of the administrative statutes: short title, purpose, definitions, definition of taxable income, credit for income taxes paid to another state (to prevent double taxation), and income tax returns.
Section 2(b)	<ul style="list-style-type: none"> <li>Repeals obsolete statutes: 105-134.7, transitional adjustments from 1989 tax law changes; 105-134.8, a hold-over re: inventories from the pre-1989 tax law; and 105-151.20, a tax credit for federal retirees for taxes paid on income for years 1985-1988.</li> <li>Repeals statutes, whose contents are incorporated into other newly created statutes: 105-134.2, income tax imposed; 105-134.3, year of assessment; and 105-134.6, adjustments to AGI. Those adjustments include the deductibility of Social Security income above the amount allowed to be deducted for federal income tax purposes, the deductibility of retirement income up to \$2,000 for private plans</li> </ul>

<sup>1</sup> The highest rates in the surrounding states are as follows: GA – 6%; SC – 7%; TN – 0%; VA – 5.75%.



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	<p>and \$4,000 for governmental plans, and the deductibility of itemized deductions.</p> <ul style="list-style-type: none"> <li>Repeals the following tax credits that do not have a sunset and that are only applicable to individual income tax: child care credit, credit for the disabled, credit for taxes paid on farm machinery, child credit, credit for charitable contributions made by non-itemizers, and credit for education expenses.</li> </ul>
Section 2(c)	Repeals the definitions for educational institution and retirement benefits. Current law allows a deduction for interest paid on obligations of a nonprofit educational institution and for a portion of a person's retirement benefits. Both of these deductions are eliminated in the bill.
Section 2(d)	Changes the statutory references to reflect the statutes in the bill.
Section 2(e)	<ul style="list-style-type: none"> <li>Makes significant changes to the individual income tax law by greatly reducing the number of adjustments that must be made to determine NC taxable income, by providing a zero percent bracket as a substitute for personal exemptions and standard or itemized deductions, and by imposing a flat tax of 6% on all income above the zero percent tax bracket.</li> <li>To determine NC taxable income, the only adjustments a person would make to AGI are as follows: <ul style="list-style-type: none"> <li>Those required to be made by federal law or North Carolina court order – amounts received under the Railroad Retirement Act, income derived from a federally recognized Indian tribe, and pension income received to the extent the amount is exempt under the <i>Bailey</i> decision.</li> <li>Those generally accepted as long-standing practice – interest on federal and State obligations.</li> <li>Those designed to prevent double taxation – refunds of income taxes.</li> <li>Those to conform to legislative decisions to decouple from federal income tax law.</li> </ul> </li> <li>The tax brackets eliminate the marriage penalty.</li> <li>The tax brackets provide a zero percent rate on income up to \$11,000 for MFJ, \$8,800 for heads of household, and \$5,500 for other filers.</li> <li>The zero percent bracket is indexed each year the same as the federal tax brackets are indexed to prevent "bracket creep" through inflation.</li> </ul>
Section 2(f)	Makes technical and conforming changes.
Section 2(g)	<p>Provides the following tax credits:</p> <ul style="list-style-type: none"> <li>A personal tax credit of at least \$200 is allowed to each taxpayer. The credit may not exceed \$800. The amount of the credit is equal to 0.6% of the taxpayer's AGI less the amount of the zero tax bracket.</li> <li>A child tax credit is allowed to each taxpayer who is allowed a federal child tax credit. The amount of the credit varies from \$450 per child to \$0 depending upon the taxpayer's AGI. Under current law, the child tax credit is \$100 and is available to taxpayers whose AGI is less than \$100,000. Under this bill, the credit amount is \$450 for taxpayers whose AGI is less than \$110,000; \$200 for taxpayers whose AGI is between \$110,000 and \$200,000; and \$0 for taxpayers whose AGI is over \$200,000.</li> <li>A tax credit for charitable contributions that may be deducted under federal law. The credit is equal to 6% of the amount deductible under federal law, not to exceed \$600.</li> </ul>
Section 2(h)	Provides that a taxpayer may not be penalized for the underpayment of income tax

	for the 2015 taxable year to the extent the underpayment is created or increased by this act.
Section 2(i)	Provides the changes to the individual income tax laws become effective for taxable years beginning on or after January 1, 2015.

## Part III. Corporate Income Tax

This Part makes two significant policy changes to the corporate income tax laws. First, it sets the corporate income tax rate at the same flat rate imposed on individuals – 6% – to ensure that all business entities are taxed at the same rate, regardless of whether they are organized as corporations, limited liability entities, partnerships, or sole proprietors.<sup>2</sup> Secondly, it moves from an apportionment formula that is based 20% upon sales to one based 75% upon sales.<sup>3</sup> This method of apportionment provides a tax reduction to a corporation with relatively large shares of its nationwide property and payroll in North Carolina but a relatively small share of its nationwide sales in North Carolina. This Part also broadens the corporate tax base by eliminating many deductions and credits and by requiring corporations to report interest expenses as income.

Bill Section	Brief Description
Section 3(a)	Reduces rate from 6.9 to 6%.
Section 3(b)	Signals the intent of the General Assembly to increase the weighting of the sales factor in the apportionment formula until it is the only factor.
Section 3(c)	Increases the weight of the sales factor from 2 (2 of 4) to 6 (6 of 8).
Section 3(d)	Conforms the interest expense deduction for financial institutions to federal law. Adds a cross-reference to the add-backs for accelerated depreciation adjustments.
Section 3(e)	Adds a cross-reference to the deductions for the add-backs for accelerated depreciation adjustments.
Section 3(f)	Repeals add-backs for prior accelerated depreciation because they are obsolete or moved to new 105-130.5B.
Section 3(g)	Repeals the following deductions: <ul style="list-style-type: none"> <li>• Deduction for interest on obligations of nonprofit educational institution [105-130.5(b)(1a)b].</li> <li>• Depreciation deductions because obsolete [105-130.5(b)(7) and (21)] or moved to new 105-130.5B [105-130.5(b)(21a), (21b), and (26)].</li> <li>• Obsolete deductions for payments received as a result of prior hurricanes [105-130.5(b)(19), (22)].</li> <li>• Deduction for part of proceeds from sale of manufactured home community [105-130.5(b)(24)].</li> </ul>
Section 3(h)	Gathers the provisions on add-backs and deductions for accelerated depreciation into a new section for ease of understanding but does not change the substance of the provisions.
Section 3(i)	Expands the royalty reporting option to include interest expense as well as royalty payments.
Section 3(j)	Repeals the credits listed below, which do not have a sunset. The repeal of credits in this section and any other section of the bill does not affect installments or

<sup>2</sup> The rates in the surrounding states are as follows: GA - 6%; SC - 5 %; TN – 6.5%; VA - 6%.

<sup>3</sup> Eighteen states, including NC, use a double-weighted sales apportionment formula. At least 15 states use a single sales factor apportionment formula. It appears GA uses single sales; VA, SC, TN, and FL appear to use double-weighted sales. NC enacted single sales factor apportionment for "capital intensive companies" in 2010 at the request of Apple.

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	<p>carryforwards of credits for which the taxpayer qualified before the credit was repealed.</p> <ul style="list-style-type: none"> <li>○ Constructing dwelling for handicapped persons (105-130.22 and 105-151.1)</li> <li>○ Constructing cogenerating power plant (105-130.25)</li> <li>○ Donating real property (105-130.34 and 105-151.12)</li> <li>○ Purchasing conservation tillage equipment (105-130.36 and 105-151.13)</li> <li>○ Gleaning crops (105-130.37 and 105-151.14)</li> <li>○ Savings and loan supervisory fees (105-130.43)</li> <li>○ Constructing poultry composting facility (105-130.44 and 105-151.25)</li> </ul>
Section 3(k)	<ul style="list-style-type: none"> <li>● Repeals the add-back for credits as part of simplification (105-130.5(a)(10))</li> <li>● Makes a conforming change to the repeal of the credit for donating to a nonprofit that acquires renewable energy property and repeals the add-back of the credit amount (105-130.5(a)(20))</li> </ul>
Section 3(l)	Extends the sunset on the low-income housing credit from 2015 to 2020.
Section 3(m)	Extends the sunset on the research and development credit from 2014 to 2020.
Section 3(n)	Sets tax years beginning on or after January 1, 2014 as the effective date for the changes made in Section 3.

## Part IV. Franchise Tax

This Part replaces the current franchise tax with a business privilege license tax applicable to all business entities that enjoy limited liability protections so that all business entities with limited liability are treated the same, regardless of whether they are organized as corporations or limited liability entities. By broadening the tax base to include more business entities, the Part is able to reduce the tax rate. This Part also repeals the annual report filing fee.

Bill Section	Brief Description
Section 4.1(a)	Renames the Franchise Tax the Business Privilege Tax.
Section 4.1(b)	Repeals various franchise tax statutes that are incorporated in the rewritten statutes in Section 4.1(c). G.S. 105-116 and 105-116.1 are repealed in Section 5.3(a) of the bill.
Section 4.1(c)	<p>Modifies the franchise tax to:</p> <ul style="list-style-type: none"> <li>● Lower the rate from \$1.50 to \$1.25 per \$1,000.</li> <li>● Increase the minimum rate from \$35 to \$200.</li> <li>● Apply to all entities that enjoy limited liability.</li> <li>● Eliminate the 55% of appraised property base.</li> <li>● Simplify the calculation of the tax by eliminating differences in GAAP accounting and the determination of the net worth base.</li> <li>● Specify when indebtedness owed to a parent, a subsidiary, or an affiliate can be deducted.</li> <li>● Prevent tax tiering by allowing a noncorporate entity to exclude its ownership interest in another noncorporate entity that is subject to the tax (105-114.7(b)).</li> <li>● Provide exclusions for regulated investment companies, REITs, and venture capital companies (105-114.7(c)).</li> <li>● Impose compensating privilege taxes at the State sales tax rate on nonregistered retailers and on nonregulated companies that produce electric power using public waters.</li> </ul>

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	<ul style="list-style-type: none"> <li>Provide revenue to cities each year in lieu of local privilege license taxes in an amount equal to a tax of .10 per \$1,000 (approximately \$45 million dollars). To make the distribution, cities are grouped in three population categories and varying percentages of the “in lieu” amount are distributed to cities in each category on a per capita basis.</li> </ul>
Section 4.1(d)	Sets the initial distribution amount under new 105-116.2, which provides revenue to cities in lieu of local privilege license taxes, at \$45 million.
Section 4.1(e)	Sets effective date of franchise tax changes as January 1, 2015 and applies to taxes payable in that year.
Section 4.2(a)	Eliminates the annual report fee for corporations.
Section 4.2(b)	Rewrites the annual report statute to eliminate the role of the Department of Revenue in receiving the annual report or approving the annual report form and reorganizes statute for clarity.
Section 4.2(c)	Eliminates \$200 annual report fee for limited liability companies.
Section 4.2(d)	Eliminates \$200 annual report fee for limited partnership.
Section 4.2(e)	Eliminates \$200 annual report fee for limited liability limited partnership.
Section 4.2(f)	Makes conforming change to repeal the annual report fee credit for LLC taxed as corporation, which is no longer needed if there is no annual report fee.
Section 4.2(g)	Makes conforming change to elimination of annual report fee.
Section 4.2(h)	Makes conforming change to elimination of annual report fee by repealing statute specifying how to account for the fees.
Section 4.2(i)	Deletes reference to annual report fee.
Section 4.2(j)	Sets effective date of repeal of annual report fee at January 1, 2015.

## Part V. Sales Tax

This Part begins to balance the State's tax structure to one more equally balanced between sales tax, individual income tax, and business taxes. The State's current tax structure relies heavily upon the individual income tax and 20% of the State's General Fund revenue comes from volatile sources of income, the corporate income tax and the non-withholding portion of the individual income tax. To provide greater stability to the State's revenue structure, this Part shifts a greater share of the revenue stream to a broad-base tax on consumption of both goods and services. As the base is broadened, the bill reduces the State rate from 4.75% to 4%.

Bill Section	Brief Description
Section 5.1(a)	Repeals exemptions for nutritional supplements sold by chiropractors (13c), newspapers (28), vending machine items (30) and (50), advertising supplements (36), and components of free circulation publications (39).
Section 5.1(b)	Sets the effective date for the repeal of these exemptions as July 1, 2013.
Section 5.1(c)	Sets July 1, 2013 as effective date of repeal of exemptions in this section.
Section 5.2(a)	Repeals privilege license taxes on entertainment and all administrative provisions in Article 2 because all of the privilege license taxes have now been repealed.
Section 5.2(b)	Makes repeal of entertainment privilege license taxes effective January 1, 2014.
Section 5.3(a)	Repeals following special taxes and discounts; electricity becomes subject to sales tax at State and local rates: <ul style="list-style-type: none"> <li>Franchise taxes on electric power, water, and public sewerage companies (105-116 and 105-116.1).</li> <li>The 3% sales tax discount for municipalities that sell electricity (105-</li> </ul>

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	<p>164.21A).</p> <ul style="list-style-type: none"> <li>• Payments in lieu of franchise taxes required of electric cities and joint power agencies (159B-27(b) through (e)).</li> </ul>
Section 5.3(b)	Repeals piped gas excise tax and sales tax exemption for piped gas. Piped gas used in manufacturing is exempt from sales tax under the exemption in 105-164.13(57) for fuel sold to a manufacturer.
Section 5.3(c)	Directs the Utilities Commission to reduce the rates for electricity and piped gas as a result of the repeal of the special taxes on electric power companies and piped gas.
Section 5.3(d)	Preserves the prohibition on local privilege taxes on electric power companies between the date the State franchise tax on these companies is repealed (January 1, 2014) and the date the general authority for cities to impose privilege taxes is repealed (July 1, 2014, under Section 6.3(b) of bill).
Section 5.3(e)	Makes repeal of special taxes on electric companies and piped gas effective January 1, 2014.
Section 5.4(a)	<p>Adds several definitions to the sales tax statutes and makes technical changes to two sales tax definitions. The added definitions are:</p> <ul style="list-style-type: none"> <li>• Alteration, repair, maintenance, cleaning, and installation services for tangible personal property (new (1c)). The items in this definition become subject to sales tax.</li> <li>• Capital equipment (new (2b)). The substance of this definition is the same as in several existing exclusions or exemptions.</li> <li>• Datacenter equipment (new (5e)). The substance of this definition is comprised of the definition in 105-187.51C(a) and 105-164.13(55).</li> <li>• Service contract (new (38b)). These are warranty and maintenance contracts for tangible personal property.</li> <li>• Short-term lease or rental (new 38(d)). Cross-references the definition used in the highway use tax, under which short-term is less than a year. Definition is applied to lease or rental of storage unit by the military.</li> </ul> <p>The definitions that are amended to make technical changes are:</p> <ul style="list-style-type: none"> <li>• Combined general rate (4a). Changes the terminology from combined general rate to combined rate, but substance the same.</li> <li>• Retailer (35). Adds a reference to sellers at flea markets. This provision is currently in 105-164.4(a)(4b).</li> </ul>
Section 5.4(b)	<ul style="list-style-type: none"> <li>• Rewrites the statute that imposes a State sales tax to eliminate preferential rates, incorporate the items to which the base is expanded, and arrange the statute in a logical order.</li> <li>• Eliminates the following preferential rates: <ul style="list-style-type: none"> <li>○ The 2%, \$300 cap rate on manufactured homes in current 105-164.4(a)(a1). Under new 105-164.4(a)(d), the sale of a manufactured home will be treated as a sale of real property with the result that the sale of the home is not subject to sales tax but the purchase of the items used in manufacturing the home are subject to sales tax.</li> <li>○ The 3%, \$1,500 cap rate on boats and aircraft in current 105-164.4(a)(1b). These sales become taxable at the general State and local rate.</li> <li>○ The 2.83% rate on electricity sold to laundries in current 105-164.4(a)(1f). These sales become exempt under revised 105-164.13(10) in Section 5.7(c).</li> </ul> </li> </ul>

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	<ul style="list-style-type: none"> <li>○ The 3% rate on electricity under current 105-164.4(a)(4a); these sales become taxable at the general State and local rate.</li> <li>○ The 2.5% rate on sales of modular homes in current 105-164.4(a)(8). Under new 105-164.4(d), the sale of a modular home will be treated the same as manufactured home described above.</li> <li>● Expands the base to add the following items, effective January 1, 2014:             <ul style="list-style-type: none"> <li>○ Computer software that is delivered or accessed electronically (new 105-164.4(b)(2)e.) The digital property category, other than computer software, is currently taxable under 105-164.4(a)(6b). The exemptions for computer software in 105-164.13(43), (43a), and (43b) apply.</li> <li>○ Service contracts for tangible personal property (new 105-164.4(b)(5)a.)</li> <li>○ Alteration, repair, maintenance, cleaning, and installation of tangible personal property (new 105-164.4(b)(5)b.)</li> <li>○ Short-term lease or rental of a mini-warehouse or other self-storage space, clothing storage, boat storage or docking, aircraft storage (new 105-164.4(b)(5)c.)</li> <li>○ Entertainment and recreation – see explanation of new 105-164.4F in Section 5.4(d).</li> </ul> </li> <li>● Recodifies but does not change tax on accommodations, prepaid telephone service, satellite radio, telecommunications service and ancillary service, video programming, and liquor.</li> </ul>
Section 5.4(c)	<p>Repeals the following sales tax provisions:</p> <ul style="list-style-type: none"> <li>● Definition of eligible internet datacenter (105-164.3(8e)) because it is incorporated in new 105-164.13E in Section 5.7(e).</li> <li>● Exemption for separately stated installation charges (105-164.13(49)) because installation of tangible personal property is taxable under Section 5.4(b).</li> <li>● Exemption for separately stated delivery charges for direct mail (105-164.13(49a)) to expand base to include all charges for delivering tangible personal property.</li> <li>● Distribution to counties of part of 2.5% State sales tax on modular homes because no longer needed under new 105-164.4(d); local sales tax from items used to construct home will be distributed in usual manner.</li> </ul>
Section 5.4(d)	<ul style="list-style-type: none"> <li>● Sets out the room accommodation sales tax provisions now in 105-164.4(a)(3) in new 105-164.4E but does not change the tax.</li> <li>● Sets out the entertainment and recreation activities included by this bill in the sales tax base in new 105-164.4F. Tax applies to charges, whether designated as admission charges, membership charges, or otherwise, for the following:             <ul style="list-style-type: none"> <li>○ Live entertainment subject to the 3% privilege license tax in repealed 105-37.1 and to amenities included in the admission price (new 105-164.4F(a)(1)a.).</li> <li>○ Movies subject to the 1% privilege license tax in repealed 105-38.1(new 105-164.4F(a)(1)b.) .</li> <li>○ Entry to museums, cultural sites, gardens, exhibits, shows, and similar attractions and to guided tours at these attractions (new 105-164.4F(a)(1)c.) .</li> <li>○ Participation in games, sports, and fitness activities (new 105-164.4F(a)(2).</li> </ul> </li> </ul>

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	<ul style="list-style-type: none"><li>○ Tax does not apply to the portion of a membership charge that is deductible as a charitable contribution or is allocable to access to facilities not used for game, sport, or fitness activity.</li><li>○ Calculation of tax when tickets are resold same as under current 105-37.1.</li></ul>
Section 5.4(e)	<p>Sets out following new exemptions from the expanded sales tax base in Section 5.4(d):</p> <ul style="list-style-type: none"><li>● Exempts tangible personal property services (service contracts, alteration, repair, maintenance, cleaning, and installation) provided for property, such as farm machinery or mill machinery, that is exempt from sales tax (new 106-164.13(60)). Exemption does not apply to motor vehicles.</li><li>● Exempts any service provided by a self-employed individual who is less than 18 years old (new 105-164.13(62)).</li></ul> <p>Preserves privilege license tax entertainment exemptions for the following (new 105-164.13(63)):</p> <ul style="list-style-type: none"><li>○ Events at elementary or secondary schools that are sponsored by the school. College events, such as basketball games, are taxable under the privilege license tax and under the bill.</li><li>○ The State Fair and local agricultural fairs.</li><li>○ Festivals sponsored by nonprofit entities that use the proceeds for their nonprofit purpose.</li></ul> <p>Exempts mini-warehouse storage rentals by members of Armed Forces for periods of less than a year (new 105-164.13(64)).</p>
Section 5.4(f)	<p>Deletes the \$1,000 highway use tax cap for Class A and B commercial motor vehicles and the \$1,500 cap for recreational vehicles that are not subject to the \$1,000 cap. Includes documentation fees and other administrative charges in the retail value of a motor vehicle sold by a dealer.</p>
Section 5.4(g)	<p>Deposits in the General Fund the increased revenue generated by removing the cap on motor vehicles and including documentation fees and administrative charges in retail value.</p>
Section 5.4(h)	<p>Sets January 1, 2014 as the effective date of the changes made by Section 5.4.</p>
Section 5.5(a)	<p>Effective July 1, 2014, further expands the sales tax base by adding the following services:</p> <ul style="list-style-type: none"><li>○ Property care and maintenance services (new 105-164.4(a)(6)), which consist of:<ul style="list-style-type: none"><li>○ Extermination and pest control.</li><li>○ Installing trees, shrubs, plants, lawns, or gardens.</li><li>○ Contract maintenance of a tree, shrub, plant, lawn, or garden.</li><li>○ Installing or maintaining walkways, retaining walls, fences, water features, or other structures to enhance the landscape of an area.</li><li>○ Cleaning the inside or outside of a building.</li><li>○ Cleaning driveways, parking lots, swimming pools, or grounds.</li></ul></li><li>○ Security services (new 105-164.4(a)(7)), which consist of:<ul style="list-style-type: none"><li>○ Guard or security patrol service.</li><li>○ Armored car service.</li><li>○ Remote monitoring of a security alarm system.</li><li>○ Locksmith service.</li><li>○ Telematic service for motor vehicles.</li></ul></li></ul>

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Section 5.5(b)	Adds new section 105-164.12D that clarifies when a landscaper is a performance contractor and when a landscaper is an installing retailer and the sales tax consequences of each.
Section 5.5(c)	Adds the following new exemptions from the services added to the base by this section: <ul style="list-style-type: none"><li>○ Extermination and pest control services provided to farmers (new 105-164.13(4h)).</li><li>○ Property care and maintenance services provided for new construction or for rights-of-way and utility easements (new 105-164.13(61)).</li></ul>
Section 5.5(d)	Sets July 1, 2014 as the effective date for the changes made by Section 5.5.
Section 5.6(a)	Splits the 2% tax on food into a 1% State tax and a 1% local tax. This shifts revenue from the local base to the State base to maintain overall revenue neutrality.
Section 5.6(b)	Changes the method for distributing the local sales tax on food from ½ per capita after applying the sales tax adjustment factor and ½ proportionate share of 1997-98 point of collection revenue to ½ per capita with no sales tax adjustment factor and ½ current point of collection.
Section 5.6(c)	Sets July 1, 2015 as the effective date for the changes made by this section.
Section 5.7	This section repeals the 1%, \$80 maximum tax that applies to manufacturers and several other businesses and provides a sales tax exemption for capital equipment that was subject to this tax. Items that were subject to the 1%, \$80 tax and are not capital equipment become subject to sales tax at the general rate. The section also revises numerous sales tax exemptions allowed various industries to exempt only capital equipment and to make items used to construct real property taxable.
Section 5.7(a)	Deletes following sales tax exemptions so that structures are treated the same across industries and only capital equipment is exempt: <ul style="list-style-type: none"><li>○ Grain, feed, or soybean storage facilities, and parts and accessories attached to the facility (105-164.13(1a)b.).</li><li>○ Facilities for housing, raising, or feeding animals or housing equipment for these activities (105-164.13(4c)).</li><li>○ Tobacco sheets, metal flues used in curing tobacco, and bulk tobacco barns and racks (105-164.13(4d)).</li></ul>
Section 5.7(b)	Repeals the 1%, \$80 maximum tax that applies to manufacturing equipment and equipment used in a few other industries and repeals the sales tax exemption for items subject to the 1%, \$80 tax.
Section 5.7(c)	Revises various sales tax exemptions as follows: <ul style="list-style-type: none"><li>○ Limits the exemption for farm machinery in 105-164.13(1) to capital equipment and eliminates the exemption for lubricants applied to farm machinery.</li><li>○ Limits the exemption for logging machinery in 105-164.13(4f) to capital equipment and eliminates the exemption for lubricants applied to logging machinery.</li><li>○ Limits the exemption for telephone company equipment in 105-164.13(5b) to capital equipment.</li><li>○ Limits the exemption for broadcasting equipment in 105-164.13(5c) to capital equipment.</li><li>○ Limits the exemption for cable company equipment in 105-164.13(5d) to capital equipment.</li></ul>

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	<p>Enacts new exemptions for the following capital equipment previously taxed at 1%, \$80:</p> <ul style="list-style-type: none"> <li>○ Specified equipment sold to a major recycling facility (new 105-164.13(5e)).</li> <li>○ Manufacturing machinery (new 105-164.13(5f)).</li> <li>○ Capital equipment of life sciences research and development company, software publishing company, and industrial refurbisher (new 105-164.13(5g)).</li> <li>○ Equipment for unloading or processing bulk cargo at a port (new 105-164.13(5h)).</li> <li>○ Datacenter machinery and equipment (new 105-164.13(5i)).</li> </ul> <p>Revises the sales tax exemption in 105-164.13(10) for items sold to laundries to limit the exemption to capital equipment, eliminate the exemption for lubricants applied to the equipment, and exempt electricity used by the laundry.</p>
Section 5.7(d)	Revises the sales tax exemptions in 105-164.13(3) and (7) for products of forests, mines, and waters to conform to the sales tax exemption for products of the farm in 105-164.13(4b) by limiting them to products in their original, as opposed to unmanufactured, state.
Section 5.7(e)	Enacts new 105-164.13E that consolidates the datacenter items previously subject to the 1%, \$80 tax with those exempt from sales tax under 105-164.13(55). Does not change substance of provisions other than to exempt the items that were previously subject to the 1%, \$80 tax.
Section 5.7(f)	Sets January 1, 2014 as the effective date for the changes made by Section 5.7.
Section 5.8	Reduces the State general sales tax rate from 4.75 % to 4.5%, effective September 1, 2014.
Section 5.9	Revises 105-467, the statute that sets the local sales tax base, to reflect the changes made by Section 5.4(b) to 105-164.4, the statute that sets the State sales tax base.
Section 5.9(a)	Eliminates unnecessary cross-references to specific items that are taxable in the State base. The local base remains the same as the State base until July 1, 2015, with the exception of food.
Section 5.9(b)	Revises the description of food effective when the 2% tax on food is split between the State and the local governments effective July 1, 2015.
Section 5.9(c)	Sets the effective dates for the changes made by Section 5.9.
Section 5.10	Sets a method for distributing local sales taxes on electricity and piped natural gas that differs from the regular method to reflect the former distributions to cities of the repealed franchise tax on electric power companies and the repealed excise tax on piped natural gas.
Section 5.10(a)	Allocates revenue from first one cent local sales tax on electricity and piped natural gas to the county of collection, directs 80% of county allocation to cities in the county based on relative property taxes of each city, and directs the remaining 20% to the county.
Section 5.10(b)	Requires revenue from first ½ cent local sales tax on electricity and piped natural gas to be distributed in the same manner as the revenue from the one cent local sales tax on electricity and piped natural gas.
Section 5.10(c)	Requires revenue from second ½ cent local sales tax on electricity and piped natural gas to be distributed in the same manner as the revenue from the one cent local sales tax on electricity and piped natural gas.
Section 5.10(d)	Sets January 1, 2014 as the effective date of the distribution method set out in this

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	section.
Section 5.11	Revises a local act concerning the Cape Hatteras Electric Membership Corporation to make it clear that the corporation is to be treated the same as every other electric membership corporation with respect to taxes other than property tax. The change becomes effective January 1, 2014.

## Part VI. Privilege License Taxes

This Part eliminates State and local privilege taxes imposed on various business entities. In 1995, the Revenue Laws Study Committee found that the privilege license tax structure was outmoded, inefficient, and not designed on proper principles of taxation such as tax fairness, ability to pay, responsiveness to growth, or administrative cost. Chapter 14 of the 1996 Session Laws, Second Extra Session, repealed most of the State privilege license taxes imposed under Article 2 of Chapter 105 of the General Statutes. The Revenue Laws Study Committee has studied the elimination of the remaining State privilege license taxes and reform of the provisions governing local privilege license taxes several times, but no statutory changes have been enacted since that time. The result is a system of taxation that applies only to a limited portion of businesses or the work force and that has a different and inconsistent tax rate for each different class of business. Consequently, the tax has become more of a nuisance tax than a properly designed source of revenue. The bill also provides a source of replacement revenue for cities from a portion of the new business license tax (*See p. 16, new G.S. 105-116.2*).

Bill Section	Brief Description
Section 6.1(a)	Repeals State privilege license taxes imposed on attorneys and other professionals (105-41), installment paper dealers (105-83), loan agencies (105-88), banks (105-102.3), and newspapers (105-102.6).
Section 6.1(b)	Sets January 1, 2014 as the effective date for repeal of the enumerated privilege license taxes.
Section 6.2	Repeals local alcoholic beverage privilege license taxes imposed in Article 2C of Chapter 105 but retains the requirement to obtain a local license. Taxes apply to holders of State beer and wine permits.
Section 6.2(a)	Deletes reference to local ABC taxes in title to Article 2C.
Section 6.2(b)	Deletes statement of purpose for local ABC license taxes.
Section 6.2(c)	Deletes requirement to pay license tax before obtaining local ABC license.
Section 6.2(d)	Deletes schedule of city beer and wine privilege license taxes.
Section 6.2(e)	Deletes schedule of county beer and wine privilege license taxes.
Section 6.2(f)	Deletes authorization for cities and counties to impose a tax on beer and wine wholesalers.
Section 6.2(g)	Sets May 1 (due date of annual payment of local ABC privilege tax) of 2014 as effective date of repeal.
Section 6.3	Repeals the authority for cities and counties to impose privilege license taxes, effective July 1, 2014.
Section 6.3(a)	Repeals the authority for counties to levy a local privilege license tax on the listed businesses; these businesses were subject to State privilege license taxes imposed until the 1980s. Counties do not have general authority to impose a privilege license tax.
Section 6.3(b)	Repeals the authority for cities to levy a local privilege license tax. Cities now have general authority to do so, subject to a hodgepodge of limitations and restrictions stemming from State privilege license taxes imposed until the 1980s.

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Section 6.3(c)	Sets July 1, 2014 as the effective date for repeal of the authority to impose local privilege license taxes.
Section 6.4	Eliminates the discounts now allowed two types of taxpayers when paying their taxes, effective July 1, 2014.
Section 6.4(a)	Repeals the 2% discount allowed to cigarette distributors when paying the cigarette excise tax.
Section 6.4(b)	Repeals the 2% discount allowed to sellers of tobacco products other than cigarettes when paying the excise tax on those products.
Section 6.4(c)	Repeals the 2% discount allowed to beer and wine wholesalers and importers when paying the excise tax on beer and wine.
Section 6.4(d)	Sets July 1, 2014, as the effective date for the repeal of the discounts.

## Part VII. Replace Local Distributions with Expanded Local Sales Tax Base

This Part recognizes that the expansion of the sales and use tax base will increase local sales and use tax revenue and eliminate the need for the current level of State tax revenues distributed to local governments. This Part reduces and simplifies the commingling of revenues as far as is practicable.

Bill Section	Brief Description
Section 7.1(a)	Repeals the annual distribution to cities and counties of part of the State excise taxes on beer and wine.
Section 7.1(b)	Deletes a reference to the beer and wine distribution repealed by Section 7.1.
Section 7.1(c)	Sets July 1, 2014 as the effective date of the repeal of the distribution of beer and wine tax revenue. Distribution is made in May of each year.
Section 7.2(a)	Repeals the local "sales tax adjustment" formula by which revenue allocated to a county on a per capita basis from the second half cent tax is increased or decreased based on sales in 1987.
Section 7.2(b)	Sets January 1, 2014 as the effective date of the repeal of the sales tax adjustment formula.
Section 7.3(a)	Reduces the county Medicaid Hold-Harmless by 50% for the 2013-2014 fiscal year.
Section 7.3(b)	Repeals the county Medicaid Hold-Harmless effective for the 2014-2015 fiscal year.
Section 7.3(c)	Sets effective dates of changes made by Section 7.3.
Section 7.4(a)	Repeals the distribution of corporate income tax revenue to the Public School Building Capital Fund. No distribution of corporate income tax has been made to that Fund since the 2008-09 fiscal year.
Section 7.4(b)	Repeals the county distribution method that applies to revenue credited to the Public School Building Capital Fund from corporate income tax revenue.
Section 7.4(c)	Sets effective date for repeal of allocation to Public School Fund. The last distribution is to be made in the final quarter of fiscal year 2013-2014.

## Part VIII. Transitional Provisions

Bill Section	Brief Description
Section 8(a)	Gives the Secretary of Revenue the authority to compromise a sales tax liability if the tax is owed on an item or service included by this act in the sales tax base and the person liable for the tax made a good faith effort to comply with the law. Effective for liabilities incurred before January 1, 2024.
Section 8(b)	Directs the Revenue Laws Study Committee to study the fiscal impact of the changes

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	made by the act, with particular attention to the application of the expanded State business tax, the impact on local governments, and the remaining methods by which the State shares revenue with local governments.
Section 8(c)	Preserves rights of taxpayers and State under taxes repealed by the act.
Section 8(d)	Makes transitional provisions effective when the bill becomes law and sets an expiration date of January 1, 2024 for the Secretary's authority to compromise a sales tax liability on items made taxable by this act.

## **Parts IX through XIII. Conforming Changes**

These Parts make numerous technical and conforming changes to statutes affected by the substantive changes made in Parts II through VIII of the act. The statutes that require conforming changes are generally set out in their numerical order in Chapter 105.